

AR43

RESERVE
RESERVE
RESERVE
RESERVE
RESERVE
RESERVE

Reserve Oil and Gas Company

This report combines the Annual Report to Shareholders and the Securities and Exchange Commission Form 10-K. Details are on page five.

Contents

Letter to Shareholders	2
Form 10-K Information	5
Description and Segments of Business	6
Exploration and Production	7
Oil and Gas Statistics	17
Trading and Transportation	19
Refining and Marketing	23
Other Operations	26
Corporate Goals	28
Financial Review	29
Five Year Summary	30
Financial Statements	32

Highlights

Financial

	1977	1976
Revenues	\$1,661,375,000	\$1,473,996,000
Net income	17,879,000	15,064,000
Common stock		
cash dividends	2,629,000	2,023,000
Shareholders' equity	188,269,000	125,805,000
Per share of common stock		
Net income (primary)	1.29	1.11
Net income (fully-diluted)	1.29	1.11
Cash dividends	.20	.17
Shareholders' equity	10.52	9.50
Working capital	90,932,000	46,904,000
Total assets	455,427,000	381,301,000
Capital expenditures and investments	45,694,000	32,602,000

Operating

Crude oil and natural gas liquids		
production, barrels per day	7,224	7,800
Natural gas production, Mcf per day	41,443	41,540
Crude oil processed, barrels per day	22,045	22,280
Crude oil and petroleum product sales, barrels per day	370,721	330,160

Annual Meeting

The 1978 Annual Meeting of Shareholders will be held at 10:00 a.m. on Tuesday, May 9, 1978 in the Auditorium, Concourse Level, Security

Pacific National Bank, 333 South Hope Street, Los Angeles, California. Advance notice of the meeting and a proxy statement will be mailed to shareholders.

Revenues

Million Dollars

73	406
74	725
75	1,021
76	1,474
77	1,661

Net Income

Million Dollars

73	10.8
74	13.7
75	17.0
76	15.1
77	17.9



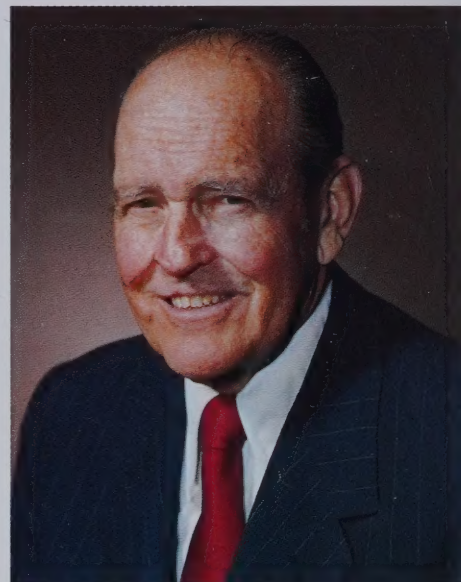
Paul D. Meadows

It is a pleasure to report continued substantial progress by your Company in 1977. Gains were achieved in all important financial areas. Net income rose to \$17.9 million, the highest level in Reserve's history. Income per share of common stock was \$1.29, an increase of 12 percent from last year.

Similar gains were achieved in gross revenues which rose 13 percent to a record high of \$1.7 billion. Assets rose 19 percent and common shareholders' equity grew nearly 11 percent to a value of \$10.52 per share.

Increased Dividend. During 1977 cash dividends of 20 cents a share were paid to holders of common stock, an increase of 25 percent from 1976. In January of this year the Board of Directors declared an increased quarterly dividend of six cents, which represents an annual rate of 24 cents a share.

Preferred Stock Underwriting. In November, two million shares of convertible preferred stock were successfully sold in the largest underwritten public offering ever undertaken by Reserve. Net proceeds



John R. McMillan

of \$47.5 million will be used principally to modernize and expand the Mohawk Petroleum refinery in Bakersfield, California. This important undertaking has been in planning for three years and was just recently announced to the public.

The Company's financial position was improved substantially by the preferred stock sale. Working capital at year-end stood at \$91 million, up from \$47 million at the end of last year. The ratio of current assets to current liabilities improved to 1.57 from 1.33 a year earlier. In addition, the ratio of debt to total debt and equity improved significantly, dropping to 31 percent from 41 percent at the end of 1976.

Chief Executive Officer. An important step in the planned development of the Company's senior management organization was taken in early 1977 when President Paul Meadows undertook the additional responsibilities of Chief Executive Officer. John McMillan, who had served in that capacity for 15 years, will continue as Chairman of the Board.

In another action, additional responsibilities of corporate Senior Vice President were given to presidents of key subsidiaries,

Cortlandt Dietler of Western Crude Oil, Inc. and Malcolm McDuffie of Mohawk Petroleum Corporation. These actions are part of a continuing effort to strengthen and broaden the Company's senior management.

Denver Executive Offices. Another significant step in the Company's development was taken late in 1977 when a relocation to Denver was completed of all of the Company's principal executive offices, with the exception of the offices of the Chairman and Secretary, which remain in Los Angeles. The move consolidates the office of the Chief Executive, corporate staff offices and two principal subsidiaries.

Oil and Gas Operations. Reserve's recent emphasis on expansion of oil and gas exploration and development continued in 1977 with participation in the drilling of 216 wells, the largest number in the Company's history. Encouraging results included discoveries in Arkansas, Oklahoma, offshore Texas and Louisiana, Colorado and in Canada, and the completion of 128 new development wells.

Several offshore areas in the Gulf of Mexico in which Reserve holds interests experienced promising discoveries in 1977 and more are expected this year. These efforts should lead to significant development and production in the years ahead.

Gulf Coast exploration efforts were broadened during the year when Reserve joined with McMoRan

In 1977 the Company's interests in Alaska were expanded through participation with Arco and Chevron USA in successful bids on 17 federal offshore lease contracts in the Lower Cook Inlet. Exploratory drilling is expected to begin in 1978. Expansion also continued during 1977 in Canada with the most active drilling program ever conducted there.

In all, a record high of over \$27.7 million was committed in 1977 to oil and gas exploration and development and plans for 1978 call for greater investment. The Oil and Gas section of the Report contains detailed information on the Company's exploration efforts.

Petroleum Trading and Transportation. In 1977 Western Crude Oil, Inc., which conducts Reserve's trading and transportation operations, continued its remarkable record of having achieved increased revenues and net income in each of its ten years in existence. All of Western Crude's operations showed substantial increases in 1977 except international trading, which experienced some decline as a reflection of weakened world market conditions.

Refining and Marketing. Mohawk Petroleum Corporation also achieved record high operating and financial results in 1977. The Bakersfield refinery operated at near capacity of 20,669 barrels of crude oil processed per day and sales of refined products rose to record high levels. Mohawk's major efforts during the next two

this reluctance reflects the concerns of Congress that the original proposals of President Carter, while laudable in their commitment to energy conservation, were inadequate in incentives vitally needed to encourage the search for new oil and gas, and incentives for research and development of other energy sources including coal, oil shale and better recovery methods for existing oil and gas reserves. We remain hopeful that an energy program providing significant incentives, including reasonably early elimination of natural gas price controls, will be passed by Congress and that the resulting impact upon the future of enterprising financially sound independent oil companies like Reserve will be positive.

The Future. The past year was a rewarding one for Reserve and we look forward to continued progress in the future. We expect 1978 to be a good year with new highs again being achieved in revenues and net income. The Company's recent declining trend in oil production should be reversed by late 1978 when production begins from the South Pelto area. Recent gas discoveries in the Gulf Coast, Arkansas and Canada should result in future increased natural gas production. With the continued high level of dedication and accomplishment of our 2,217 employees and the long-time and very welcome support of our nearly 20,000 shareholders, we should accomplish our objectives.

Denver Executive Offices

The principal Executive Offices of Reserve Oil and Gas Company were relocated effective January 15, 1978 from Los Angeles to Denver, Colorado. The move consolidated offices of the President and Chief Executive Officer, principal members of corporate management and headquarters of two major subsidiaries, Reserve Oil, Inc., and Western Crude Oil, Inc. The offices of the Chairman of the Board and the corporate Secretary remain in Los Angeles.

The move was an important step in Company plans to strengthen the corporate organization and shorten

lines of communication with operating subsidiaries. In addition, the consolidation will result in operating efficiencies and better application of corporate controls.

The move was also an historic step for Reserve, which was founded in California in 1932 and has always maintained executive offices in that state, first in San Francisco and for the past 14 years in Los Angeles.

The choice of Denver as the principal place of business for Reserve Oil and Gas Company was made for several reasons. Denver, often described as the new energy capital of America, is centrally located in the western half of the nation where significant energy developments involving coal, uranium

and oil shale, as well as oil and gas, will take place in the next several years.

Denver is also centrally located among Reserve's principal areas of activity in Canada to the north, the Gulf of Mexico to the south, Arkansas to the east and California to the west.

Many energy companies with which Reserve does business are headquartered in Denver or have established major western headquarters there. The city is also rapidly growing as a financial, legal and governmental center.

Principal Offices

- Reserve Corporate
- Subsidiary Corporate
- Exploration & Production
- Trading & Transportation
- Refining & Marketing



Form 10-K Information

Information usually reported separately in an annual report to shareholders and in a Securities and Exchange Commission Form 10-K has been combined by Reserve into one integrated Annual Report to provide maximum information to shareholders and to eliminate costs of duplication. The Commission has not approved or disapproved this Annual Report nor passed upon its accuracy or adequacy. The location of specific Form 10-K items is indicated to the right and the formal Form 10-K Title Page is reproduced below.

Item 1	Business	6-28
Item 2	Summary of Operations	30
Item 3	Properties	6-28
Item 4	Parents and Subsidiaries	44
Item 5	Legal Proceedings	44
Item 6	Increases and Decreases in Outstanding Securities and Indebtedness	45
Item 7	Changes in Securities and Changes in Security for Registered Securities	45
Item 8	Defaults upon Senior Securities	46
Item 9	Approximate Number of Security Holders	46
Item 10	Submission of Matters to Vote of Security Holders	46
Item 11	Executive Officers of Registrant	46
Item 12	Indemnification of Directors and Officers	47
Item 13	Financial Statements, Exhibits Filed and Reports on Form 8-K	47
Items 14	through 18	48

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KAnnual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 1977

Commission file number 1-3474

Reserve Oil and Gas Company

Incorporated in California I.R.S. Employer No.: 94-0801550

Principal Executive Offices: 1776 Lincoln Street
Denver, Colorado 80203 (303) 861-7800

Securities registered pursuant to Section 12(b) of the Act:

Common Stock

New York Stock Exchange
Pacific Stock Exchange

ITEMS 1 and 3**The Business and Properties of the Company****Business Description**

Reserve Oil and Gas Company is an independent energy company engaged, through four principal operating subsidiaries, in three primary lines of business: oil and gas exploration and production; petroleum trading and transportation; and refining and marketing. The Company is also engaged in contract drilling, land development and manufacturing.

Oil and Gas Exploration and Production

Reserve Oil, Inc. conducts oil and gas operations principally in California, the Rocky Mountain and Mid-continent regions and in the

Texas-Louisiana Gulf Coast area. Limited activities are conducted in Colombia and the Gulf of Oman. Canadian Reserve Oil and Gas Ltd. is principally engaged in oil and gas operations in western Canada.

Petroleum Trading and Transportation

Western Crude Oil, Inc. engages in the sale, purchase and transportation of crude oil and petroleum products in both United States and international markets. In the United States Western Crude also operates gathering and transmission pipeline systems, oil tank trucks and crude oil storage terminals.

Refining and Marketing

Mohawk Petroleum Corporation, Inc. owns and operates a refinery at Bakersfield, California. Petroleum products are marketed through Mohawk-brand service stations and

other outlets in California and Arizona. Western Crude Oil, Inc. is engaged in wholesale and retail marketing in the Rocky Mountain and Mid-continent regions.

Other Operations

Basin Drilling Corp. is engaged in contract drilling of oil and gas wells. Real estate is developed and sold in Apple Valley, California. Dehydration equipment and feed processing systems are built by R.A.F. Corporation. Trend Construction Corporation designs and installs natural gas processing plants. A landfill methane gas recovery system is under development by Reserve Synthetic Fuels, Inc.

Information as to Business Segments

The following table sets forth for the periods indicated the amounts and percentages of revenues, operating profit and identifiable assets of Reserve allocable to its primary business segments. Prior years' lines of business data have been restated to conform to the Financial Accounting Standards Board's Statement No. 14, "Financial Reporting for Segments of a Business Enterprise".

	1977		1976		1975		1974		1973	
	(In thousands, except per cent data)									
Revenues (including intersegment sales)										
Exploration and production	\$ 43,215	2.6%	\$ 39,073	2.7%	\$ 28,065	2.7%	\$ 23,124	3.2%	\$ 15,550	3.8%
Trading and transportation	1,318,619	79.3	1,230,191	83.4	833,775	81.6	576,097	79.5	316,720	78.0
Refining and marketing	312,156	18.8	209,384	14.2	181,368	17.8	141,653	19.5	69,886	17.2
Other operations	36,251	2.2	27,613	1.9	3,754	.4	4,030	.6	4,436	1.1
Intersegment sales	(48,866)	(2.9)	(32,265)	(2.2)	(25,849)	(2.5)	(20,183)	(2.8)	(585)	(.1)
Total Revenues	\$1,661,375	100.0%	\$1,473,996	100.0%	\$1,021,113	100.0%	\$724,721	100.0%	\$406,007	100.0%
Operating Profit										
Exploration and production	\$ 11,226	26.1%	\$ 7,736	20.9%	\$ 11,029	30.8%	\$ 9,422	30.9%	\$ 4,328	19.0%
Trading and transportation	12,645	29.4	11,670	31.6	14,272	39.8	12,496	41.0	12,175	53.5
Refining and marketing	15,897	36.9	15,263	41.3	10,820	30.2	8,428	27.6	5,475	24.1
Other operations	3,274	7.6	2,278	6.2	(281)	(.8)	154	.5	781	3.4
Total Operating Profit	43,042	100.0%	36,947	100.0%	35,840	100.0%	30,500	100.0%	22,759	100.0%
Non-operating expenses, principally interest	(12,795)		(10,806)		(4,504)		(4,226)		(4,013)	
Income before income taxes	\$ 30,247		\$ 26,141		\$ 31,336		\$ 26,274		\$ 18,746	
Identifiable Assets										
Exploration and production	\$ 152,338	33.5%	\$ 136,567	35.8%	\$ 80,747	26.3%	\$ 67,320	27.9%	\$ 60,206	30.6%
Trading and transportation	154,152	33.8	159,252	41.8	167,290	54.5	123,678	51.3	94,487	48.1
Refining and marketing	80,486	17.7	47,500	12.5	36,476	11.9	33,326	13.8	26,671	13.6
Other operations	29,293	6.4	22,167	5.8	12,663	4.1	13,156	5.5	12,120	6.2
Corporate assets	39,158	8.6	15,815	4.1	10,057	3.2	3,762	1.5	3,059	1.5
Total Assets	\$ 455,427	100.0%	\$ 381,301	100.0%	\$ 307,233	100.0%	\$241,242	100.0%	\$196,543	100.0%

Oil and Gas Exploration and Production



Oil and Gas Exploration and Production

In 1977 Reserve continued its accelerated search for new oil and gas reserves, participating in the drilling of 216 wells, the highest number in its history. Exploratory drilling resulted in discoveries in Arkansas, Oklahoma, offshore Texas and Louisiana, Colorado and Canada. Development drilling resulted in 128 new completions.

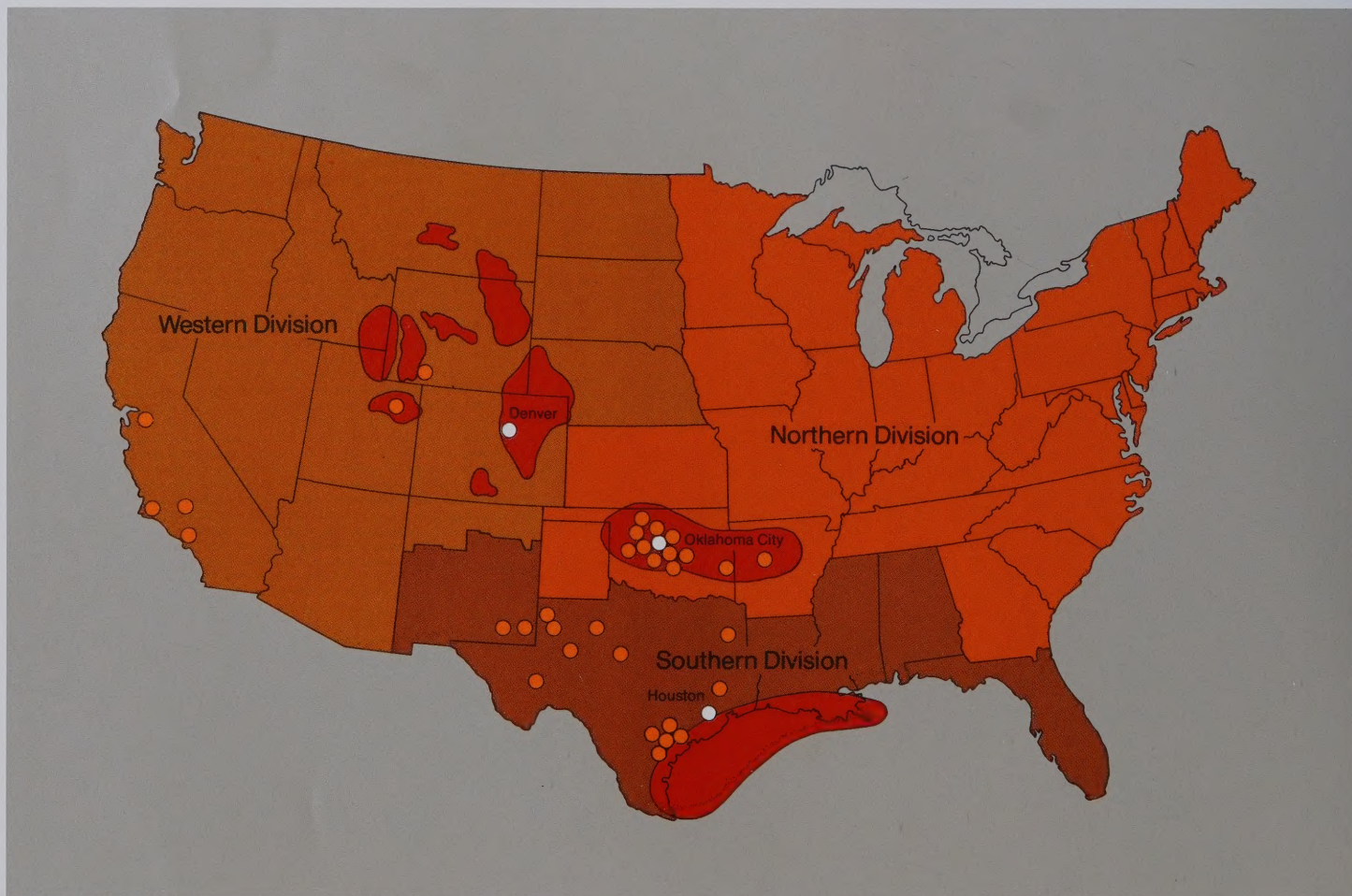
During the past four years, Reserve has added more than 78 billion cubic feet of new natural gas to its reserves, resulting after production in an eleven percent increase in proved gas reserves. Proved crude oil reserves, which had been declining over the past several years, showed an encouraging reversal in 1977, increasing six percent over 1976 by the addition of over 1.6 million barrels of new oil reserves. As a result, the decline in oil reserves over the past four years was reduced to ten percent. Further improvement in the Company's reserves is expected during 1978 as strong emphasis continues on exploration in the United States and Canada.

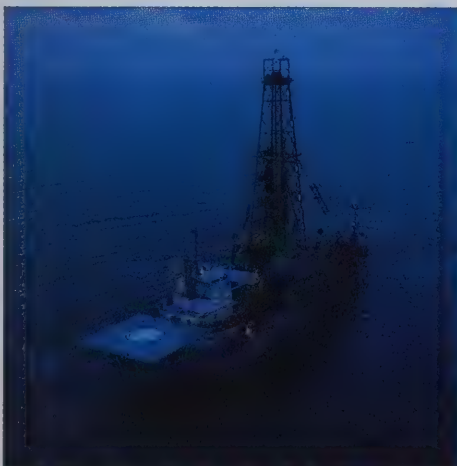
UNITED STATES

In 1977 Reserve Oil, Inc., the Company's oil and gas subsidiary, participated in the drilling of 18 exploratory and 63 development wells. This drilling resulted in 9 new discoveries and 56 successful development wells.

Gulf Coast Area

The first full year of the Company's participation in an exploratory program in the Gulf Coast area of Texas and Louisiana has resulted in three significant discoveries.





Drillship working at nighttime in Gulf of Mexico

In Block 340/366/367 of the Brazos area offshore Texas, Rutherford Oil Corporation as operator for a group in which Reserve's interests range from 6.67 to 11.67 percent has drilled three exploratory wells, resulting in two commercial gas discoveries which have been production-tested for a combined rate of 14.7 million cubic feet of gas per day.

Total acreage in this block is 5,580 acres. Two additional wells will be drilled in 1978 and negotiations are underway for the marketing of this gas.

The Rutherford Group also holds 5,760 acres in Galveston Block 104, where three successful wells have been drilled to date. Plans call for drilling three additional wells this year.

In South Pelto Block 13, offshore Louisiana, the Company owns a 13.5 percent interest in a group operated by Mesa Petroleum Company. In July was announced that the first well drilled on this block had resulted in a significant oil discovery with three pay zones. Two of the zones tested for a combined rate of 1,925 barrels of oil per day.

Four additional wells have since been drilled and a sixth well is currently drilling. A production platform is being fabricated and should be installed in August or September of this year with initial production anticipated in late 1978.

Reserve Oil, Inc.

- Principal Areas of Oil & Gas Production
- Principal Areas of Exploration Activity
- Division Offices





Jack-up rig in South Pelto area of Gulf of Mexico

Two additional wells are scheduled for drilling on Block 13. In June, the group successfully bid on three additional blocks totaling 12,500 acres which are contiguous to the original discovery block of 5,000 acres.

On October 1, 1977, the Company entered into a joint venture with McMoRan Exploration Company and three other firms to acquire farmouts and drill exploratory wells on offshore federal leases in the Gulf of Mexico. This is a three-year program with an estimated yearly budget of \$20 million. Reserve owns a 14 percent interest in the program.

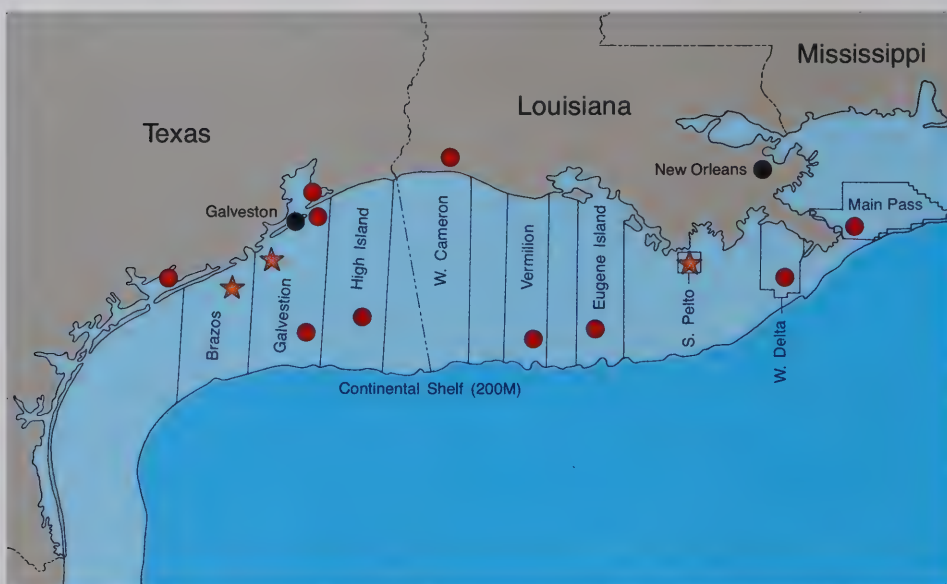
Mid-continent Area

The Company's continuing exploratory and development program in the Arkoma Basin resulted in the completion of four additional gas wells. In the Red Oak Area of LeFlore County, Oklahoma, the Company completed a follow-up to the Hatters Farm discovery well which was drilled in 1976. The Tolbert #21-1 was production-tested as a dual gas producer for a combined 13.1 million cubic feet of gas per day. The

Company has negotiated a satisfactory sales contract and these two wells are now producing. Reserve Oil, Inc. owns a 37.5 percent interest in these wells. At least two additional wells are proposed for drilling in this area during 1978.

In the Augsberg Area of Pope County, Arkansas, the Company participated in the drilling and completion of two follow-up wells to the discovery made last year. All three wells are now producing. The Company owns interests varying from 20 to 39 percent in a 2,000-acre lease block.

In the Moreland Area of Pope County the Company drilled a new field discovery, the Sam Jones #36-1. This well, in which Reserve holds a 19.5 percent interest, penetrated five separate productive zones and was completed from dual zones for a combined initial production rate of 15.6 million cubic feet of gas a day. Reserve is operator for a group which holds over 3,900 acres in the



Gulf Coast Area

- Principal Exploration Areas
- ★ 1977 Discoveries

0 25 50 75 100
Miles



Reserve well being drilled in Oklahoma portion of the Arkoma basin

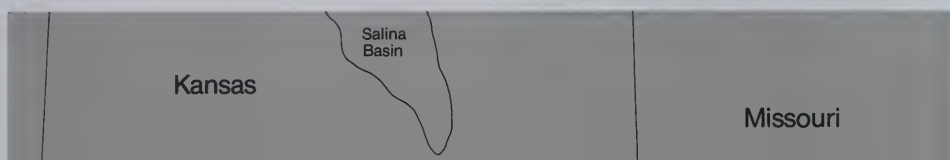
immediate area in which Reserve owns interests varying from 11 to 19.5 percent. At least three follow-up wells are planned for 1978.

In Prairie County, Arkansas the Company is currently drilling a significant wildcat on a 16,000-acre lease block. The well, Hazen #28-1, is

programmed for a total depth of 16,500 feet and will test all formations to and including the Arbuckle. Reserve owns a 25 percent interest in this well.

In Dewey County, Oklahoma, the Company completed the Winter #9-2 as a new field discovery in the Red Fork sand of Pennsylvanian age. Initial production was 1.5 million cubic feet

of gas a day and 126 barrels of condensate. A follow-up well is scheduled in early 1978. Reserve owns a 50 percent interest in the well and in a 3,000-acre lease block surrounding



Mid-continent Area

- Principal Exploration Areas
- ★ 1977 Discoveries

0 50 100 150 200



Mohawk 1-16 well in Wyoming Overthrust Belt

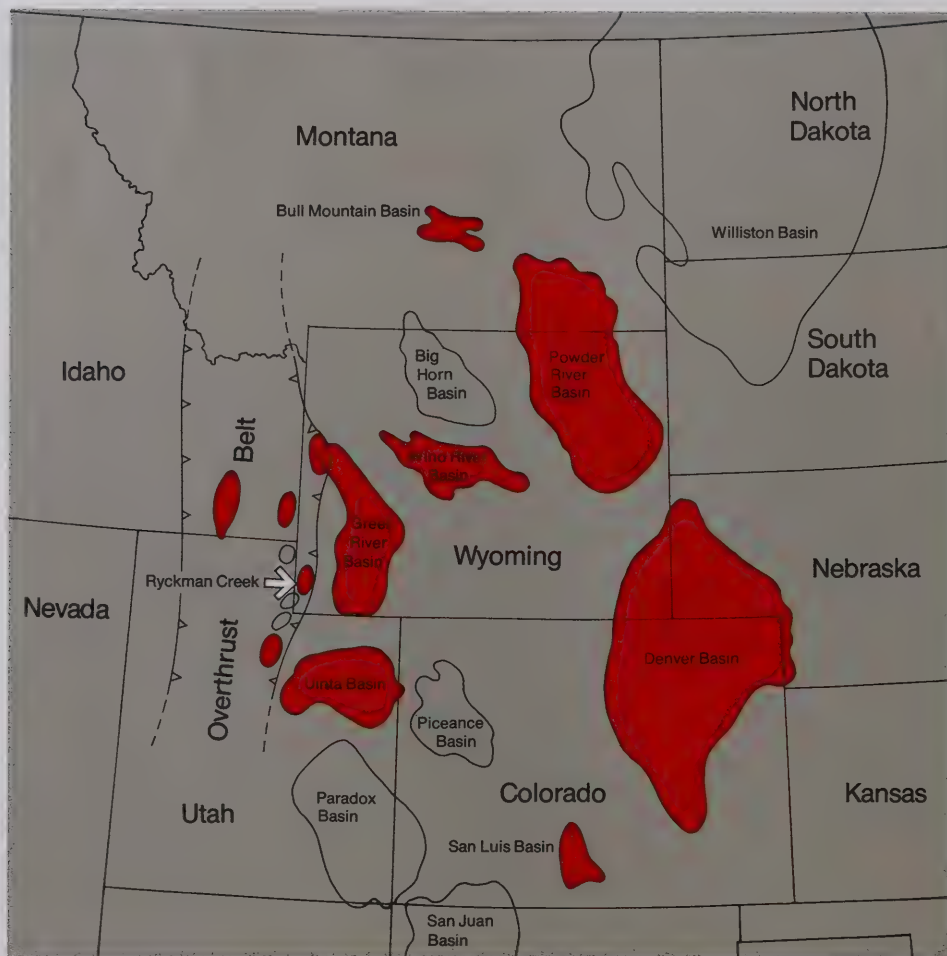
Rocky Mountain Area

In Uinta County, Wyoming, where the Company owns 2,880 acres, a second exploratory well, the Mohawk State #1-16, commenced drilling in mid-January. The well is located midway between the prolific Ryckman Creek Field and the recently discovered Painter Reservoir Field. The Company's first well, the Mohawk State #1-36, was drilled to a depth of 8,994 feet but was not productive.

In Bear Lake County, Idaho, Reserve has acquired 100 percent interest in 1600 acres and an average of 55 percent in 13,800 acres. The acreage is located in the Idaho portion of the Overthrust Belt and within an area of

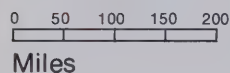
continuing exploratory activity. Geological and geophysical investigations on these lands are planned for this coming year.

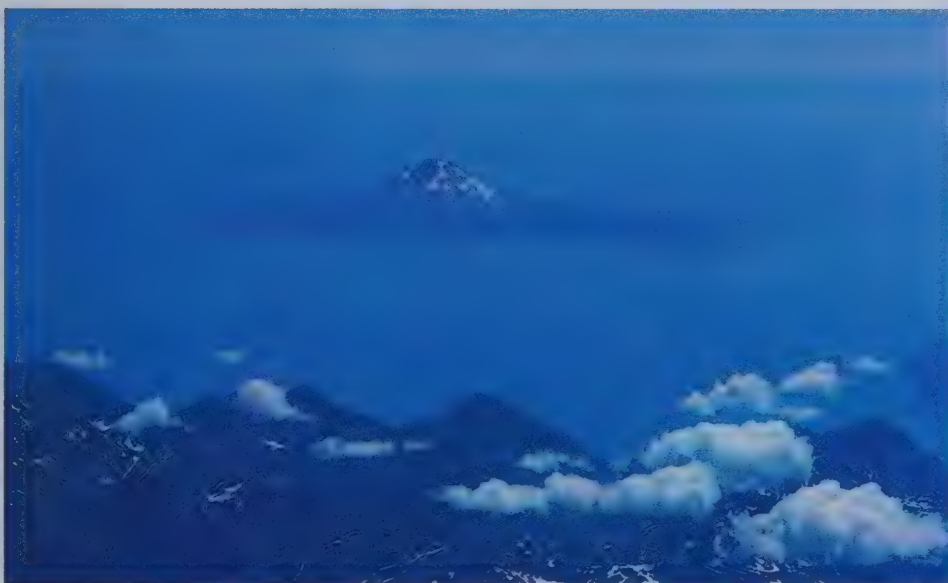
West of the Ryckman Creek Area in the Idaho portion of the Overthrust Belt, the Company has filed on approximately 121,000 acres of federal and state lands. As to 102,000 acres in this block, certain use stipulations may be imposed by the Bureau of Land Management. At this time, the Company is optimistic that such stipulations will not preclude exploratory activity.



Rocky Mountain Area

■ Principal Exploration Areas





Lower Cook Inlet of Alaska

Alaska

On October 27, 1977, Reserve's 80 percent-owned subsidiary, Halbouty Alaska Oil Company, joined the Arco/Chevron U.S.A. group in acquiring 17 federal offshore lease tracts in the Lower Cook Inlet of Alaska. Reserve owns a 5.6 percent interest in these tracts, which were acquired for a total of \$51.4 million. It is anticipated that exploratory drilling will commence in the summer of 1978.



Lower Cook Inlet-Alaska

- Producing Fields
- Reserve Leaseholdings

0 10 20
Miles



Pumping unit in the Lloydminster area

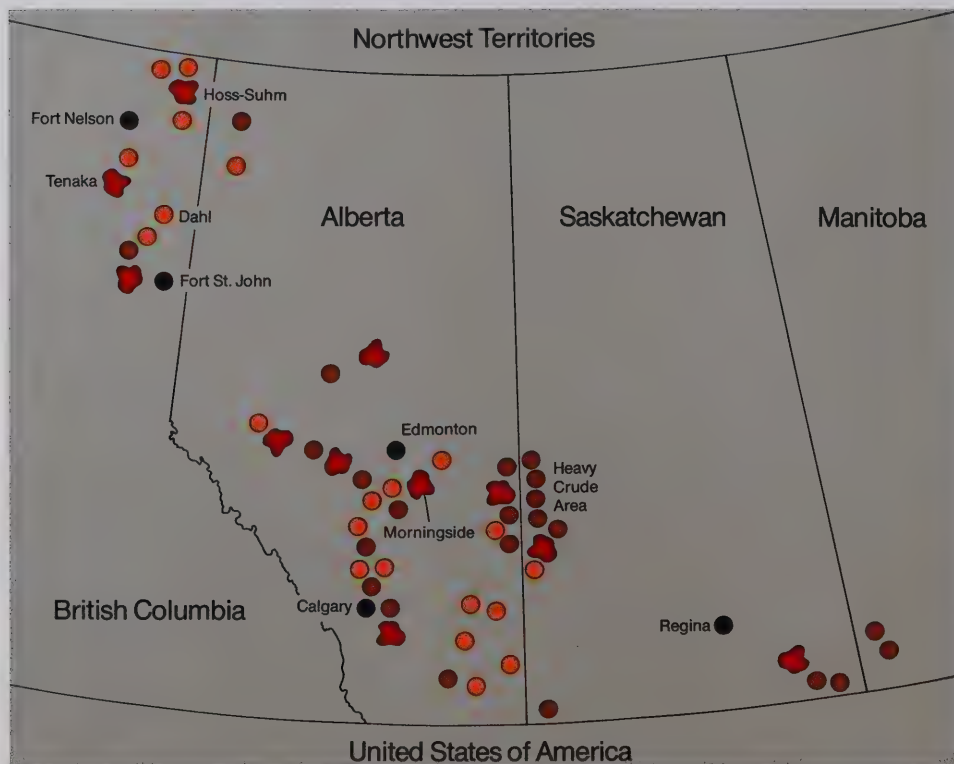
CANADA

Canadian Reserve Oil and Gas Ltd., a publicly owned company whose stock is owned 88.3 percent by Reserve, carried out the most active exploratory and development program in its history during 1977. The program included a continuation of exploration and development in the natural gas area of northeastern British Columbia and a resumption of exploration and development in the heavy crude oil areas of Alberta and Saskatchewan.

Gross working interest crude oil production increased 17 percent in 1977 as a result of increased production of heavy crude oil. Net production after deduction of royalties, however, decreased seven percent from the 1976 level as a direct result of changes in the Saskatchewan royalty system which affect net sales volumes but do not reduce total net income.

Daily average gross volumes of natural gas produced in 1977 increased three percent to a level of 22.1 million cubic feet from a 1976 rate of 21.4 million cubic feet. Net production also increased but was lowered by increased royalty rates in Alberta. The Alberta royalty formula involves an automatic increase in the royalty rate when the price of natural gas to the producer increases.

Significant gas discoveries were made in four areas of British Columbia. In the Hoss Area the Company participated in the drilling of a gas discovery which tested at the rate of 10.6 million cubic feet of gas a day. By its participation, the Company earned a 28 percent interest in the well and in 3,840 acres around it. Follow-up geophysical work and a second well are planned for early 1978.



Canadian Reserve Oil and Gas Ltd.

- Principal Gas Development Areas
- Principal Oil Development Areas
- Principal Exploration Areas



Storage facilities in Saskatchewan heavy crude oil area

In the Suhm Area the Company participated in the drilling of a discovery well which tested at the rate of 38.5 million cubic feet of gas a day. At least one additional follow-up well will be drilled in 1978. The Company owns a 37.5 percent working interest in the well and in 9,100 acres surrounding it and has an option to earn a 25 percent interest in an additional 8,700 acres.

At Tenaka the Company drilled a gas discovery which was completed as a producer from two separate zones. The well was production-tested at a combined rate of 11.4 million cubic feet of gas a day. Two additional wells are planned in the area in 1978. The Company owns a 13.75 percent working interest in the well and in 34,500 acres surrounding it.

In the Dahl Area the Company participated in the drilling of four exploratory wells on two large blocks to earn a 25 percent working interest in a total of 100,000 acres. This drilling resulted in three gas discoveries. Extensive development and exploratory drilling is planned for early 1978. Production from this area should commence in April 1978.

In central Alberta the Company concentrated its exploratory and development efforts in the Morningside Area. During 1977 the Company participated in the drilling of 11 wells, resulting in three gas completions, three oil completions and five dry holes. Two of the gas completions were located on lands in which Canadian Reserve owns a 100 percent interest in approximately 22,400 acres in the Morningside Area and on which the Company plans an extensive seismic and drilling program in 1978.

During the second half of 1977 Canadian Reserve resumed an aggressive exploratory and development program in the heavy crude oil areas of Alberta and Saskatchewan, participating in the

drilling of 48 wells which resulted in two gas wells, 30 oil wells and 16 dry holes.

In the Bodo-Hayter Area of Alberta the Company, with partners, drilled 10 exploratory wells resulting in five oil completions, one gas completion and four dry holes. The Company holds interests which vary from 6.25 to 25 percent in approximately 82,000 acres in this area. The Company was successful in extending the Bodo-Hayter field to the south where four exploratory wells were completed as oil wells.

As a consequence of higher returns and improved marketing conditions, the Company plans to continue an aggressive exploration and development program in its efforts to add additional heavy crude oil reserves.

OVERSEAS

During the second quarter of 1977, the Reserve Fujairah #1 well, located offshore Fujairah in the Gulf of Oman, was abandoned at a depth of 9,349 feet in Cretaceous sediments. Insurmountable technical problems encountered during drilling forced the premature abandonment of this test. Through association with participants, this well was drilled at minimum cost to Reserve.

The Company is now integrating newly acquired geophysical and well data with the information gained from the recent well, towards the possibility of causing a second well to be drilled on another seismic structure.



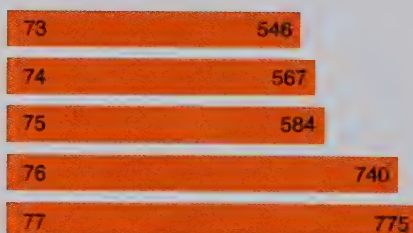
Hazen 28-1 wildcat well being drilled in Arkansas

The Company has retained its concession rights, totaling about 700,000 acres, with the Government of Fujairah; however, the Sharjah concession area has been relinquished.

Activity in Colombia during 1977 was confined to producing five existing wells. These wells produced a total of 692,940 barrels of crude oil, 69,294 net to the Company, at an average rate of 190 barrels-a-day. No additional drilling is anticipated during the coming year.

Reserve Oil and Gas Company

Total Producing Wells — Net



Oil and Gas Statistics

Net Oil Production

	1977	1976	1975	1974	1973
Crude Oil and Natural Gas Liquids (barrels)					
United States	1,409,881	1,543,428	1,383,192	1,411,601	1,322,239
Canada (1)	1,157,505	1,248,460	1,566,862	1,829,596	2,107,201
Overseas	69,294	63,404	—	—	—
Total	2,636,680	2,855,292	2,950,054	3,241,197	3,429,440

(1) After royalty payments. Oil production in Canada before royalty payments was 1,876,463 barrels in 1977 and 1,607,043 barrels in 1976.

Net Gas Production

	1977	1976	1975	1974	1973
Natural Gas (Mcf)					
United States	9,670,630	10,048,948	5,953,284	6,134,250	5,824,662
Canada	5,456,142	5,157,809	4,940,936	5,366,762	5,248,929
Overseas	—	—	—	—	—
Total	15,126,772	15,206,757	10,894,220	11,501,012	11,073,591

Producing Wells

	Oil		Gas		Total	
	Gross	Net	Gross	Net	Gross	Net
United States	2,498	307.94	516	98.05	3,014	405.99
Canada	3,275	331.95	409	36.29	3,684	368.24
Overseas	5	.62	—	—	5	.62
Total	5,778	640.51	925	134.34	6,703	774.85

Three oil wells and thirteen gas wells contain more than one completion.

Acreage

Developed Acreage

	Gross	Net
United States	351,138	51,865
Canada	358,520	110,443
Overseas	1,280	160
Total	710,938	162,468

Undeveloped Acreage

	Gross	Net
United States	828,065	442,685
Canada	3,853,480	1,321,333
Overseas	1,952,865	471,368
Total	6,634,410	2,235,386

Wells Drilled — Exploratory

	1977	1976	1975	1974	1973
Gross Oil	11	11	11	11	17
Gross Gas	23	20	5	10	16
Gross Dry	40	54	42	51	57
Total	74	85	58	72	90
Success Ratio	45.9%	36.5%	27.6%	29.2%	36.7%
Net Oil	2.64	3.78	5.70	3.47	5.98
Net Gas	7.39	6.06	2.18	3.04	4.03
Net Dry	13.29	18.15	14.02	17.12	17.75
Total	23.32	27.99	21.90	23.63	27.76

Wells Drilled — Development

	1977	1976	1975	1974	1973
Gross Oil	63	41	26	17	55
Gross Gas	65	51	9	9	12
Gross Dry	14	8	6	8	6
Total	142	100	41	34	73
Success Ratio	90.1%	92.0%	85.4%	76.5%	91.8%
Net Oil	32.73	17.84	14.39	4.65	10.54
Net Gas	6.79	13.71	2.28	1.78	0.51
Net Dry	6.89	4.40	2.65	2.61	0.95
Total	46.41	35.95	19.32	9.04	12.00

Availability of Oil and Gas — 1978

	Crude Oil and Natural Gas Liquids (barrels)	Natural Gas (Mcf)
United States	1,319,000	10,425,000
Canada	1,189,000	5,898,000
Overseas	33,000	—
Total	2,541,000	16,323,000

Net Reserves (January 1, 1978)

	Crude Oil and Natural Gas Liquids (barrels)	Natural Gas (Mcf)	Sulfur (Long Tons)
Proved Developed			
United States	15,035,000	78,068,000	—
Canada	11,065,000	142,310,000	686,900
Overseas	90,000	—	—
Total	26,190,000	220,378,000	686,900
Proved Undeveloped			
United States	389,000	873,000	—
Canada	765,000	32,628,000	—
Overseas	—	—	—
Total	1,154,000	33,501,000	—
Total Proved Net Reserves	27,344,000	253,879,000	686,900

During 1977 estimates of oil and gas reserves were filed in four reports to Federal agencies. The Company's net reserves were estimated as of January 1, 1977 in a Form S-7 Registration Statement filed June 6, 1977, with the Securities and Exchange Commission. Net reserves were estimated as of June 30, 1977, in a Form S-7 Registration Statement filed October 11, 1977, with the Securities and Exchange Commission. A Form 40 report was submitted to the Federal Energy Regulatory Commission October 4, 1977, showing estimated reserves as of December 31, 1976. The Form 40 report sets forth reserves before royalty interest while reserves reported by Form S-7 and in this Form 10-K are shown after royalty interest. Estimates submitted during 1977 by Form S-7 and this Form 10-K do not materially differ except with respect to interim production and normal adjustments. On March 28, 1977, a report on Form 64 was submitted to the Federal Power Commission reporting non-associated additions to Alaskan gas reserves for the year 1976. No estimates of reserves were filed with foreign governments during 1977.

Petroleum Trading and Transportation





Crude oil tank truck plays important part in integrated transportation system

Western Crude Oil, Inc., Reserve's petroleum trading and transportation subsidiary, continued to experience substantial growth during 1977 with gross revenues increasing 10 percent and net income 20 percent from 1976. In the past five years, net income has nearly doubled and revenues have more than quadrupled.

On 1 March 1977, Western Crude Oil celebrated the tenth anniversary of its founding, marking a decade of remarkable achievement. The Company's success was well established in June, 1967 when it became the first purchaser of crude oil in the newly discovered Belle Creek Field in remote southeastern Montana and built its first pipeline system to

serve the area. Western Crude Oil continues to purchase and transport the major portion of the field's production.

From its modest beginning, Western Crude Oil expanded rapidly through internal growth and acquisition of other companies to an international organization with operations in all major oil producing regions in the United States and western Canada, coupled with trading and transportation activities throughout the world.

Wesco Pipe Line Company, a wholly owned subsidiary of Western Crude, owns and operates 23 common carrier pipeline systems in nine states totaling over 2,000 miles in length. The Company also owns significant interests in Butte Pipe Line Company, Texoma Pipe Line Company and Wascana Pipe Line, Ltd., which operate nearly 1,000 miles of major trunk pipeline systems.



Crude oil storage terminal at Cushing, Oklahoma

At Cushing, Oklahoma, a modern crude oil terminal operated by a subsidiary, Western Crude Terminals, Inc., has been recently expanded to two million barrels capacity.

Another subsidiary, Pontotoc Oil Company, markets natural gas liquids and other petroleum products. Canyon Pipe Line Corporation and Uinta Pipeline Corporation transport natural gas and associated liquids. International trading and transportation activities are conducted throughout the world under the Wesco International, Inc. and Easco S.A. subsidiaries.

Reported elsewhere under the refining and marketing segment of this Annual Report are Western Crude Oil's petroleum products marketing activities. In the Rocky Mountain and Mid-continent areas, wholesale marketing of gasoline and diesel fuel is directed by Spruce Oil Corporation, and motor gasoline is marketed at retail through over 60 self-serve outlets by Automatic Gas Distributors, Inc.

Western Crude Oil is a leader in efforts to develop the proposed 1,550 mile Northern Tier Pipeline designed to transport crude oil from Port Angeles, Washington to the United States heartland at Clearbrook, Minnesota. This 40- and 42-inch common carrier pipeline is the most direct and embargo-proof method proposed to equitably distribute Alaskan North Slope and other offshore crude oil directly to refiners in the Mid-continent, Midwest and Rocky Mountain regions of the United States. New support for the proposed 1.3 million barrel-per-day pipeline system was received in 1977 when United States Steel Corporation joined the project.

Western Crude Oil takes pride in its decade of growth from a regional Rocky Mountain company to an international organization with annual revenues approximating \$1.5 billion. The Company is especially cognizant of its dedicated employees without whose imagination, interest and loyalty such a record would not have been possible.

Western Crude Oil is continuing its expansion in a number of areas. Full operation began late in 1977 on a recently acquired and renovated 80-mile crude oil pipeline system extending from Bonanza, Utah to Fruita, Colorado. The pipeline crosses some of the most scenic and difficult terrain in the West, with a vertical climb and drop of 6,649 feet that required development of an intricate and complex system of automated controls.

The Fairview pipeline system in eastern Montana and western North Dakota is being expanded to serve new oil production being developed in this portion of the Williston Basin. Exploration and development activity here is expected to be very extensive for the next several years.

Construction of a \$2.5 million 10-mile underwater common carrier gathering and transmission pipeline has been proposed off the Louisiana coast. The line will serve offshore oil production discovered by Reserve and others in the South Pelto area of the Gulf of Mexico.



Cushing terminal has two million barrel capacity



Total pipeline operations cover over 3,000 miles

Management required to support Western Crude Oil's expansion was strengthened during 1977 and early 1978. Among key promotions were D. Dale Shaffer to Vice President/General Counsel in addition to duties as Corporate Secretary; H. Michael Compton to Vice President/Controller, remaining as Chief Accounting Officer; Richard F. Desch to Treasurer in addition to remaining Credit Manager; and Donald H. Anderson to Manager/Crude Oil Trades and Exchanges. Early in 1978, Erik B. Carlson joined Western Crude Oil as Associate General Attorney.

Key management appointments in subsidiary companies included James H. Armstrong as Vice President/Operations, Automatic Gas Distributors, Inc.; Joe C. deGraffenried as Vice President/General Manager, Wesco Pipe Line Company; and John D. Thees, Jr., as Vice President/Refined Products, Pontotoc Oil Company.

On 1 March 1978 Jay L. Lammons was named Corporate Vice President of Western Crude Oil, Inc. Lammons will be responsible for all worldwide petroleum product marketing, supply and transportation activities of the Company and its subsidiaries. Prior to joining Western Crude Oil in Denver, Lammons was Vice President/Crude and Product Supply for Tenneco Oil Company in Houston.

During 1977 Western Crude Oil continued its established goal of increased sales and higher earnings in each year of operation while simultaneously completing a planned consolidation of various operations. This record confirms management's confidence that Western Crude Oil, Inc., as it begins its second decade, will maintain its record of an ever-increasing scope of operation and return on investment.



Pipelines and Terminal

- Pipeline Terminal
- Company-Owned Pipelines
- Partially-Owned Pipelines
- Proposed Pipeline





Mohawk gasoline is delivered to over 240 service stations in California and Arizona

In 1977 the refining and marketing segment of Reserve continued to experience the growth enjoyed over the past several years. Mohawk Petroleum Corporation, Inc., the Company's major refining and marketing subsidiary, achieved increased levels of product sales, gross revenues and net profits for the eighth consecutive year since joining Reserve.

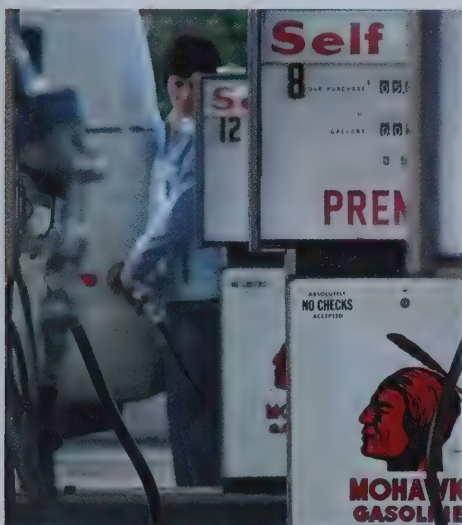
Sales during 1977 of petroleum products by Mohawk amounted to 571 million gallons, or 37,266 barrels per day, an increase of 28 percent from the prior year. The increase in gasoline volume was especially strong, while lesser increases were achieved in diesel fuel and heavy fuel oil sales.

The total number of Mohawk-supplied retail outlets in California and Arizona stood at 243 at year-end. Of the total, 168 were Mohawk-brand outlets and the balance were stations that rebranded products to other trade names. Thirty-five of the branded outlets were company-operated stations which averaged 167,000 gallons each per month at year-end.

Through Western Crude Oil, Inc., the Company operates as a wholesale purchaser and marketer of refined petroleum products in the Rocky Mountain and Mid-continent areas and markets gasoline through approximately 60 retail self-service outlets, usually in conjunction with convenience stores. The Company also operates as a wholesale purchaser and marketer of natural gas liquids.

At Mohawk's Bakersfield, California, refinery, crude oil runs averaged a record 20,669 barrels per day. A total of 55 percent of Mohawk's petroleum product marketing requirements was provided by the refinery's production, with the balance being obtained by purchases and crude processing arrangements with other refiners.

Faced with increasing federal and state restrictions on the lead content of gasoline and the sulfur content of heavy fuel oils, plus the operating inefficiencies of a 45-year-old refinery, the Company announced in January, 1978, the undertaking of a major refinery modernization and expansion program at Bakersfield.



Self-service at Mohawk station

The project, which had been under intensive study for three years, will consist principally of a 30,000 barrel per day (bpd) crude unit, an 11,000 bpd vacuum unit, a 6,000 bpd naphtha desulfurizer/reformer, a 15,000 bpd gas oil desulfurizer, and related support facilities.

The project will require a capital expenditure of approximately \$50 million, the largest petroleum refinery investment ever made in California outside of the Los Angeles and San



Employees remain key to marketing success

Francisco metropolitan areas. It is being made because of a combination of circumstances that should result in a very favorable return on investment. Bakersfield is located in the heart of central California's San Joaquin Valley, a growing petroleum market that includes California's richest agricultural area. The refinery is close to crude oil sources that represent half of California's total production, including the prolific Naval Petroleum Reserve at Elk Hills.

The refinery will be the first in the area able to produce low sulfur fuel oil from local crude oil, and the refinery will be

able to produce the unleaded gasoline that is increasingly being required for automobile use in California. Upon completion, the refinery will have achieved an overall reduction in air and water pollutant emissions, despite a substantial increase in total crude capacity.

Completion of refinery construction is planned for the fall of 1979. During construction the existing facilities will continue to be operated without interruption. The modernized refinery should add significantly to revenues and profits generated by the refining and marketing segment of the Company.

In two separate actions by the Department of Energy during 1977, Mohawk was substantially relieved from the obligation to purchase entitlements under the federal government program to equalize costs of crude oil among refiners. Relief presently has been granted through May, 1978.

Mohawk Petroleum Corporation

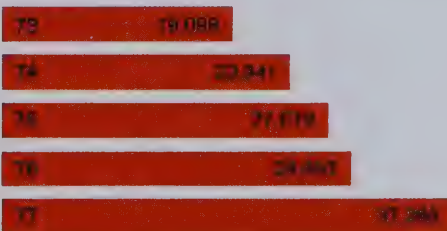
Crude Oil Refined

Refined Products Sales

Barrels Per Day



Barrels Per Day



Other Operations



One of nine drilling rigs owned by Basin Drilling Corp.

In addition to its three main areas of business, Reserve has a number of other operations which together contribute 7.6 percent of corporate operating profits. They include contract well drilling, equipment manufacturing, land development and landfill gas production.

Basin Drilling Corp. operates nine land-based drilling rigs and is active in the Oklahoma area drilling oil and gas wells under short-term contracts with other companies. During 1977 the rigs were in operation 92 percent of total available time compared with an 87 percent rate last year, reflecting a strong demand for land-based drilling rigs that is expected to continue for some time.

Basin Drilling in 1977 recorded its second consecutive year of record-high revenues and net profit. The company also recorded an impressive safety record during the year with one of the lowest injury rates in the industry.

Reserve's Apple Valley Ranchos Division develops land at Apple Valley, California, a high desert community of approximately 12,000 persons located 90 miles east of Los Angeles. Approximately 9,500 acres are currently owned in the area, largely in noncontiguous blocks that at year-end were encumbered by only \$210,200 of debt.

Real estate sales totaled \$743,950 in 1977 including a motel and commercial lot. Sales of new residential property continued to be restricted by environmental problems affecting Apple Valley and surrounding communities, particularly relating to sewage disposal requirements. The Company is making every effort to resolve these problems.

Revenues from the Company's 101-room Apple Valley Inn resort hotel and wholly-owned water utility increased in 1977 so that total revenues for Apple Valley Ranchos Division rose to \$3.8 million, compared with \$3.3 million in 1976.

A methane gas recovery plant owned by Reserve Synthetic Fuels, Inc. at the Palos Verdes, California, landfill operated successfully throughout



Residence in Apple Valley development

1977, delivering pipeline quality gas on a continuous basis to the Southern California Gas Co. Favorable feasibility studies have been completed at two privately owned Southern California landfills and permits have been filed for construction of gas processing facilities at both sites. Scheduled for construction in Arizona in 1978 is a low BTU landfill facility for sales of gas to an industrial user.

During 1977 an agreement was reached with NRG, Inc., formerly a joint venture partner and Hughes Aircraft Company, NRG's major stockholder, whereby Reserve acquired all of the assets and interest in the landfill gas recovery program, in consideration for NRG being granted a future net profits interest in certain applications of the program.

R.A.F. Corporation, a 58 percent-owned subsidiary, designs and builds dehydrating equipment. Trend Construction Corporation designs and installs natural gas processing plants. In Long Beach, California, Reserve owns and leases nine warehouses.

Reserve management believes that its first responsibility is to generate increased profits that will provide a fair return to shareholders and insure the Company's growth. But Reserve also recognizes that in conducting its business it has a responsibility to see that, wherever possible, its actions have a positive effect upon peoples' welfare, improve the environment, conserve natural resources and strengthen the economy. This commitment to good corporate citizenship is carried out in a number of ways.

Energy. The United States faces a shortage of energy that could have severe consequences for the national welfare. Reserve recognizes that it has an opportunity as an energy company to contribute directly to lessening of that shortage. The Company has made a substantial commitment of its resources and manpower to the search for new oil and gas and in 1978 has budgeted for that purpose the largest capital expenditures in its history.

Environment. Reserve actively pursues projects that are designed to protect and improve the environment and believes that such a policy is particularly important for a petroleum company. Pipelines, terminals and tank trucks are regularly monitored to minimize the possibility of environmental pollution. Vapor containment equipment has been installed on service station pumps and storage tanks. Protective equipment and procedures are carefully maintained at oil and gas wells and drilling sites, and related facilities.

In planning for the Bakersfield refinery modernization and expansion, protection of the environment has been a prime concern. Pollutant

emission levels at the modernized refinery will be lower than they are today, even though capacity will be expanded considerably. It is estimated that the cost of installing new equipment related principally to control of pollution will reach \$8 million.

Total expenditures by Reserve and its subsidiaries in 1978 for facilities and equipment for environmental control and improvement will be approximately \$2.9 million. For 1979, capital expenditures related to environmental control and improvement will be approximately \$8.6 million. These projections are subject to adjustments that may be required by State and Federal laws which cannot be fully anticipated.

Conservation. The Company has a commitment to conserve the use of energy wherever possible, including its several truck fleets, drilling operations and office facilities. Another facet of energy conservation is the effort being made to find better methods of recovering additional hydrocarbons from wells that otherwise have become non-productive.

Conservation efforts are also applied in all drilling operations so that the environment is disturbed as little as possible and minimum use is made of natural resources, particularly water. In all of these efforts, the Company cooperates fully with all governmental agencies.

Employment. The management of Reserve believes it has a responsibility to see that the Company provides fair employment opportunities and fair opportunities for advancement for all persons without discrimination as to race, color, religion, sex, age or national origin. A long-standing corporate policy has existed in this regard.

At the end of 1977, Reserve and its subsidiaries provided full and part-time employment for a total of 2,217 people. This compares with 2,042 employees last year and continues the growth trend of recent years. Much of the success of the Company is due to the diligence and loyalty of these employees.

Approximately 240 employees are members of national labor unions and are covered by collective bargaining agreements that establish rates of pay, wages, hours and other working conditions. Reserve management considers that the Company's relationship with its employees and the unions concerned is satisfactory. No significant work interruptions have occurred in the last seven years.

Public issues. Reserve believes that management has a responsibility to speak out on important public issues, particularly when they relate to energy. A current issue of concern is the increase in restrictions being placed on the use of public lands. Some 62 percent of land designated as federal domain has already been essentially closed to exploration and development of energy minerals. Strong efforts are underway to gain further restrictions, with the aim of creating large wilderness areas benefiting only the estimated one percent of the population that participates in primitive-area recreation. Not only do such restrictions deny use of public lands to the vast majority of people, they deny to the public the vitally needed energy reserves that exist on public lands. It is hoped that this trend to severely limited use of federal lands can be halted.



Corporate senior management: R. Bruce Bailey, President, Canadian Reserve Oil and Gas Ltd.; Cortlandt S. Dietler, Senior Vice President and President, Western Crude Oil, Inc.; Paul D. Meadows, President and Chief Executive Officer; John R. McMillan, Chairman of the Board; Harold F. Green, Senior Vice President; Malcolm McDuffie, Senior Vice President and President, Mohawk Petroleum Corporation, Inc.

Four primary goals have been identified by Reserve management to guide the Company's operations over the next several years: continued growth; improved profitability; increased organizational efficiency and better cost control; and improved total return to shareholders.

Good opportunities for growth in the energy segment of our economy will continue to exist provided a sound national energy policy is adopted that includes reasonable incentives to the energy industry. It appears certain that the demand for energy will continue to grow.

Reserve management intends to capitalize upon this situation by emphasizing the Company's existing strengths as a hydrocarbon-oriented company and devoting current major efforts to that area of business. This will not preclude, however, interests in other phases of the energy business and profitable opportunities in all energy-related areas will be pursued.

While short-term opportunities relate to hydrocarbon reserves, it is recognized that these are limited and other energy sources must be considered for the long-term needs of the nation.

A broad base of operations covering different areas of the petroleum industry will be continued and a healthy financial structure will be maintained to provide management flexibility. The advantage of this was shown with the Company's ability to measure changing trends in requirements for unleaded gasoline and low sulfur fuel oil and capitalize upon them by undertaking a modernization of the Bakersfield refinery well ahead of competition.

The primary objectives of the Company during the next few years relate to increased profitability. Major emphasis will be on growth in earnings and resultant increased return on shareholders' equity. Programs to meet these objectives will include improved financial controls, concentration of efforts on the most profitable operations, increased production of oil and gas and a more responsive and efficient organizational structure.

Reserve's management philosophy emphasizes decentralized operations with subsidiary companies and divisions having responsibility for

on-going operations and accountability for results. The parent corporate organization provides policy, financial supervision and certain legal, personnel, insurance and other staff services. Initial steps have already been taken to increase organizational efficiency. The office of the Chief Executive, parent corporate staff offices and the executive offices of two principal subsidiaries have been consolidated in Denver. A study of future personnel needs is underway.

A key management goal is improving return to shareholders, both in terms of dividends and through appreciation in stock value. Since payment of cash dividends on common stock began in 1974, Reserve has increased the dividend rate each year. This reflects the Company's objective of paying dividends that keep pace with increasing earnings consistent with a reasonable balance between return to shareholders and earnings needed to support future growth.

Equally important is long-term appreciation in the market price of Reserve stock. Success in the Company's several goals should improve recognition by the investment community of the intrinsic worth of Reserve stock. Hopefully this will result in increased market value.

Reserve management is convinced that the future in the energy field will be marked by opportunities of uncommon dimension. These opportunities will be seized upon, whether through internal development and expansion, acquisition or merger, to maximize the value of an investment in Reserve's future.

Earnings and Revenues. Reserve's net income totaled \$17,879,000 in 1977, a record high for the Company, and up 19 percent from \$15,064,000 reported for 1976. Primary earnings per share of common stock, after preferred dividend requirements, were \$1.29 per share in 1977 compared with \$1.15 per share for the year 1976. Fully-diluted earnings also amounted to \$1.29 per share in 1977 compared with \$1.13 per share in 1976. The improved results in 1977 were largely due to increased volumes of crude oil purchased and sold in domestic markets, increased sales at higher prices for purchased and refined petroleum products and increased prices and earnings from Canadian crude oil and natural gas production. Partially offsetting these gains were losses incurred in foreign trading operations and foreign exchange rate losses with respect to translation of accounts carried in Canadian dollars.

Gross revenues were also a record high in 1977 and totaled \$1.66 billion, up 13 percent from \$1.47 billion in 1976. Reserve's increased revenues are attributable to increased volumes of purchased crude oil and petroleum products sold at higher prices in domestic wholesale and retail markets. These increases were partially offset by a decline in foreign sales of crude oil due to world-wide market conditions.

Funds flow from operations amounted to \$36.0 million in 1977, up 9 percent from 1976. Capital expenditures totaled \$41.9 million for the year, of which approximately 66 percent was used in oil and gas exploration and development and 34 percent was utilized in transportation, refining, marketing and other operations.

Financing. In November 1977, two million shares of cumulative convertible preferred stock were sold for \$50,000,000 in a public offering. The preferred stock issued carries a dividend rate of \$1.75 per share and has a liquidation preference of \$25.00 per share. The stock is convertible into common stock at \$17.125 a share, representing a conversion ratio of 1.46 shares of common for each share of preferred. The net proceeds from the offering were \$47.5 million after underwriting and other stock issuance costs. The funds received will be used principally to modernize and expand the Company's Mohawk Petroleum refinery in Bakersfield, California. The refinery project is described elsewhere in this report.

Financial Position. Reserve's financial position improved substantially in 1977 as a result of the preferred stock offering. Working capital at the end of 1977 amounted to \$91 million, up from \$47 million at the end of the previous year. Cash and short-term investments totaled \$73 million at year-end compared with \$38 million at the end of 1976. The ratio of current assets to current liabilities rose to 1.57 from 1.33 a year earlier. The analysis of the change in the elements of working capital are reported in the financial statements following this review.

Notes and other long-term liabilities amounted to \$85 million at year end, down from \$89 million at the end of the prior year. Capitalization at December 31, 1977, comprised of notes and other long-term payables and shareholders' equity, increased to \$273 million and was represented by debt equal to 31% and shareholders' equity of 69%. The book value of shareholders' equity at the end of 1977 amounted to \$10.52 per share of common stock.

Capital Stock. Reserve Oil and Gas Company Common Stock is traded on the New York and Pacific Stock Exchanges and is quoted in the Wall Street Journal and in other major newspapers. Reserve's new \$1.75 Preferred Stock was listed on the New York and Pacific Stock Exchanges effective December 16, 1977 and is also quoted in the publications noted above. The market price of the preferred stock ranged from a high of \$24.625 per share to a low of \$23.500 in the period December 16 to December 31, 1977. The quarterly per share ranges for Reserve's common stock are tabulated below:

Quarter	Market Prices Per Common Share			
	1977		1976	
	High	Low	High	Low
First	\$21.000	\$15.750	\$13.250	\$ 7.625
Second	21.250	15.125	12.500	10.875
Third	21.375	15.125	16.500	9.750
Fourth	16.250	12.250	18.750	13.750

Dividends. Cash dividends on Reserve's common stock were paid at the rate of 20 cents per share in 1977, an increase of 25 percent over the dividend rate paid in 1976. The first dividend was also paid on Reserve's new \$1.75 preferred stock issue at the rate of \$.192 per share for the period from date of issue, November 22, to December 31, 1977. The amount of preferred dividends paid in 1977 was \$384,000. The cash dividends paid on the Company's common stock in 1977 and 1976 were as follows:

Year	Cash Dividends on Common Stock		
	Quarterly Rate	Annual Rate	Amount
1977	\$.05	\$.20	\$2,629,000
1976	.04	.16	2,023,000

ITEM 2.**Summary of Operations**

The following consolidated summary of operations of Reserve Oil and Gas Company for the five years ended December 31, 1977 is not reported upon by certified public accountants.

Consolidated Summary of Operations

(In thousands, except per share amounts)	1977	1976	1975	1974	1973
Revenues	\$1,661,375	\$1,473,996	\$1,021,113	\$724,721	\$406,007
Cost of sales and operating expenses	1,573,879	1,394,589	960,133	673,895	362,888
Depletion, depreciation and abandonments	19,021	19,306	9,138	7,488	9,187
Interest expense	9,015	7,198	2,076	2,177	1,762
Provision for income taxes	12,368	11,077	14,317	12,597	9,978
Income before extraordinary items	\$ 17,879	\$ 15,064	\$ 17,019	\$ 13,677	\$ 8,768
Extraordinary items	—	—	—	—	2,000
Net income (b)	\$ 17,879	\$ 15,064	\$ 17,019	\$ 13,677	\$ 10,768
Net income attributable to common stock	\$ 17,495	\$ 14,796	\$ 16,616	\$ 13,254	\$ 10,345
Per share of common stock (a)					
Primary:					
Income before extraordinary items	\$1.29	\$1.15	\$1.35	\$1.08	\$.68
Extraordinary items	—	—	—	—	.16
Net income	\$1.29	\$1.15	\$1.35	\$1.08	\$.84
Assuming full dilution:					
Income before extraordinary items	\$1.29	\$1.13	\$1.31	\$1.06	\$.68
Extraordinary items	—	—	—	—	.15
Net income	\$1.29	\$1.13	\$1.31	\$1.06	\$.83
Dividends	\$.20	\$.16	\$.12	\$.10	—
Number of common shares (a):					
Primary	13,575	12,886	12,314	12,273	12,271
Assuming full dilution	13,913	13,363	12,987	12,922	12,939

a) Primary income per common share is based upon weighted average common shares outstanding and common stock equivalents for assumed exercise of stock options and warrants in each year where applicable, after provision for preferred dividend requirements. Fully-diluted income per share is based upon the weighted average number of common shares and common share equivalents outstanding during each year and the assumed conversion of preferred shares into common shares.

b) Revenues from Reserve's foreign operations and Reserve's equity in net income after related deferred income taxes are as follows:

(In thousands)	1977	1976	1975	1974	1973
Revenues	\$ 382,359	\$ 559,925	\$ 336,059	\$116,781	\$ 57,894
Equity in net income	4,705	4,824	3,549	2,695	4,730

**Management's Discussion and
Analysis of the Consolidated
Summary of Operations**
1977 vs. 1976

Revenues in 1977 totaled \$1.66 billion, an increase of 13% from 1976. Each of Reserve's major entities contributed to the \$187 million increase. The following table summarizes the relative components of the sales increase:

Increased crude oil purchased and sold in the U.S.	15%
Increased purchased and refined petroleum products marketed in the U.S.	6%
Decreased trading and transporting of foreign crude oil	(9%)
Other	1%
	13%

Crude oil purchased and sold in the U.S. increased 34% over 1976 (31% due to volume factors and 3% due to price factors) while purchased and refined petroleum products marketed in the U.S. increased 40% (24% due to volume factors and 16% due to price factors). Offsetting these increases was a 40% decline in the trading and transporting of foreign crude oil (2% increase from price factors offset by a 42% decrease from volume factors).

Cost of sales and operating expenses increased to \$1.57 billion from \$1.39 billion in the prior year. The 13% increase corresponded to the increase in sales (summarized in the above table). Increased cost of sales and operating expenses also reflect the continuing effect of inflation on labor, material and supply costs and increased entitlements purchase obligations under the Department of Energy's Old Oil Entitlements Program.

Selling and administrative expenses totaled \$28.4 million versus \$25.9 million in 1976. The 10% increase is primarily due to inflation and higher employment costs. Depletion, depreciation and abandonment expense decreased \$285,000 to \$19.0 million in 1977. The decline resulted from a \$2.7 million reduction in dry hole costs offset by a \$1.8 million increase in depletion and depreciation expense and a \$583,000 increase in costs associated with the surrender of undeveloped leases. Interest expense increased 25% to \$9.0 million as the result of additional financing obtained in June, 1976 for the acquisition of Basin Petroleum Corp. Income taxes increased \$1.3 million to \$12.4 million due to increased pre-tax income.

Net income totaled \$17.9 million in 1977, up \$2.8 million from 1976. The 19% increase resulted from the combination of factors described above.

1976 vs. 1975

Revenues amounted to \$1.47 billion in 1976, an increase of 44% over revenues of \$1.02 billion reported in 1975. Approximately 51% of the sales growth is attributed to increased sales of foreign crude oil (33% due to volume factors and 18% due to price factors) and 12% of the growth is due to increases in foreign petroleum products purchased and sold (20% from volume factors, offset by an 8% reduction from price factors). The remainder is a result of higher sales of domestic crude oil purchased and sold, increased sales of purchased and refined petroleum products in domestic markets and revenues attributable to the operations of the former Basin Petroleum Corp. (Basin), which was acquired by Reserve in a purchase transaction in January, 1976.

Cost of sales and operating expenses totaled \$1.39 billion in 1976, up 45% over the 1975 period. This increase stems from higher volumes of crude oil and petroleum products purchased, together with increases in the cost of labor, materials and supplies. Depletion, depreciation and abandonments amounted to \$19.3 million in 1976, an increase of \$10.2 million over similar expense in 1975. Approximately \$4.3 million of this is attributable to operation of the former Basin properties and \$3.6 million is related to dry hole and other exploration costs resulting from increased oil and gas exploration activity. The costs associated with the surrender of undeveloped leases amounted to \$548,000 in 1976 compared to \$94,000 in 1975. Interest expense amounted to \$7.2 million in 1976, up from \$2.1 million in 1975 due to increased debt outstanding with respect to the financing of the Basin acquisition. Income tax expense was down \$3.2 million, from \$14.3 million in 1975 to \$11.1 million in 1976, due to reduced pre-tax income in 1976 and a lower effective tax rate with respect to Canadian operations.

Net income was down 11% in 1976 as a result of three factors: (1) a substantial increase in exploration activity, (2) interest expense related to the acquisition of Basin, and (3) a decline in margin and earnings on foreign sales of crude oil and petroleum products, notwithstanding increases in sales volumes.

1975 vs. 1974

Total revenues in 1975 amounted to \$1.02 billion, an increase of 41% over the 1974 period. This increase was attributable to increased volume of domestic and foreign petroleum product sales and crude oil sales with respect to resale operations, coupled with increased unit prices. Increased prices were also received in 1975 for crude oil and natural gas produced and sold, but volumes were down slightly compared with sales in 1974. Interest, dividend and other revenues declined \$3.4 million in 1975 as a result of lower interest rates, a decrease in funds available for investment and reduced ship charter revenues.

Cost of sales and operating expense amounted to \$960.1 million in 1975, up 42% over 1974. This increase was a result of increased cost of crude oil purchased and increases in the cost of labor, materials and supplies. Depletion, depreciation and abandonments increased in 1975, due primarily to increased expense relating to oil and gas exploration activity. Income tax expense increased \$1.7 million in 1975 compared with 1974, due to increased pre-tax income. The lower effective tax rate was principally attributable to an increase in investment tax credits. The combination of all of these factors resulted in an increase in net income of \$3.3 million in 1975 or 25% over net income reported in the prior year.

Consolidated Statement of Income

Year ended December 31 (In thousands, except per share amounts)	1977	1976
Revenues	\$1,661,375	\$1,473,996
Costs and expenses:		
Cost of sales and operating expenses (Note 3)	1,573,879	1,394,589
Selling and administrative expenses	28,404	25,871
Depletion, depreciation and abandonments (Note 11)	19,021	19,306
Interest expense	9,015	7,198
Minority interest	809	891
	1,631,128	1,447,855
Income before income taxes	30,247	26,141
Provision for income taxes (Note 6)	12,368	11,077
Net income (Note 11)	17,879	15,064
Preferred dividend requirements (Note 5)	384	268
Income attributable to common stock	\$ 17,495	\$ 14,796
Per share of common stock:		
Primary	\$1.29	\$1.15
Assuming full dilution	\$1.29	\$1.13
Dividends (Note 4)	\$.20	\$.16

See accompanying notes and schedule.

Consolidated Statement of Shareholders' Equity

(In thousands)	Preferred stock	Common stock	Capital in excess of par value	Retained earnings	Treasury stock	Total
Balance at December 31, 1975	\$7,217	\$12,347	\$23,492	\$65,684	\$(25)	\$108,715
Net income	—	—	—	15,064	—	15,064
Cash dividends:						
Preferred stock	—	—	—	(268)	—	(268)
Common stock	—	—	—	(2,023)	—	(2,023)
Exercise of stock options	—	182	937	—	—	1,119
Conversion of preferred stock	(3,826)	364	3,462	—	—	—
Redemption and cancellation of preferred stock	(155)	—	45	—	16	(94)
Issuance of warrants in conjunction with acquisition of Basin Petroleum Corp.	—	—	3,283	—	—	3,283
Exercise of warrants	—	1	8	—	—	9
Balance at December 31, 1976	3,236	12,894	31,227	78,457	(9)	125,805
Net income	—	—	—	17,879	—	17,879
Cash dividends:						
Preferred stock	—	—	—	(384)	—	(384)
Common stock	—	—	—	(2,629)	—	(2,629)
Exercise of stock options	—	26	127	—	—	153
Conversion of preferred stock	(3,210)	230	2,980	—	—	—
Redemption of preferred stock	(26)	—	(3)	—	—	(29)
Issuance of preferred stock	2,000	—	45,462	—	—	47,462
Exercise of warrants	—	1	11	—	—	12
Retirement of treasury shares	—	(5)	(4)	—	9	—
Balance at December 31, 1977	\$2,000	\$13,146	\$79,800	\$93,323	\$ —	\$188,269

See accompanying notes and schedule.

Consolidated Balance Sheet

December 31	1977	1976
(In thousands)		
Assets		
Current assets:		
Cash and short-term investments of \$58,814,000 (\$17,049,000 in 1976) (Note 4)	\$ 73,028	\$ 38,274
Accounts receivable	142,296	129,272
Installment contracts, commissions and notes receivable, net (Note 2)	4,018	2,338
Inventories (Note 3)	28,223	19,265
Prepaid expenses	1,505	1,672
Total current assets	249,070	190,821
Long-term receivables and investments:		
Installment contracts, commissions and notes receivable, net (Note 2)	7,303	9,405
Investments, at lower of cost or market	7,045	8,372
	14,348	17,777
Properties, at cost:		
Oil and gas properties	185,030	165,036
Refining, manufacturing and distributing facilities	64,836	55,124
Commercial and other properties	18,325	16,685
	268,191	236,845
Less accumulated depletion and depreciation	82,994	71,340
	185,197	165,505
Other assets, at cost less amortization	6,812	7,198
	\$455,427	\$381,301
Liabilities and Shareholders' Equity		
Current liabilities:		
Notes payable (Note 4)	\$ 3,666	\$ —
Current maturities of long-term debt (Note 4)	5,330	5,161
Accounts payable	133,025	130,428
Accrued liabilities	8,023	4,572
Income taxes payable	8,094	3,756
Total current liabilities	158,138	143,917
Notes and other long-term payables (Note 4)	85,223	88,590
Deferred income taxes (Note 1)	17,128	17,106
Minority interest	6,669	5,883
Contingent liabilities (Note 8)		
Shareholders' equity (Notes 4, 5, 7 and 11):		
Preferred stock:		
\$25 par and involuntary liquidating value; authorized 800,000 shares in 1976, issued 129,450 shares	—	3,236
\$1 par value; authorized 4,000,000 shares; issued 2,000,000 shares; involuntary liquidating value — \$50 million (\$25 per share)	2,000	—
Common stock, \$1 par value; authorized 30,000,000 shares; issued 13,146,402 shares in 1977 and 12,893,989 shares in 1976 (including 4,767 treasury shares in 1976)	13,146	12,894
Capital in excess of par value	79,800	31,227
Retained earnings	93,323	78,457
Treasury stock, at cost	—	(9)
Total shareholders' equity	188,269	125,805
	\$455,427	\$381,301

See accompanying notes and schedule.

Consolidated Changes in Financial Position

Year ended December 31	1977	1976
Source of funds:		(In thousands)
Operations:		
Net income	\$17,879	\$ 15,064
Items not involving working capital:		
Depletion, depreciation and abandonments	19,021	19,306
Provision for non-current portion of deferred income tax	22	2,359
Other (including minority interest)	(895)	(3,866)
Total from operations	36,027	32,863
Collections on long-term notes receivable	5,890	2,327
Proceeds from exercise of stock options	199	1,150
Proceeds from loans	6,279	126,380
Proceeds from sale of properties and investments	9,912	960
Net proceeds from issuance of preferred stock	47,462	—
Other	1,303	1,666
	107,072	165,346
Disposition of funds:		
Additions to properties	41,896	30,836
Payments and other decreases in long-term liabilities	10,342	63,314
Additions to investments and other assets	3,798	1,766
Purchase of Basin Petroleum Corp., including working capital deficit of \$4,369,000 (assets acquired consist principally of properties)	—	42,961
Additions to long-term notes receivable	3,752	5,242
Dividends	3,013	2,291
Other	243	813
	63,044	147,223
Increase in working capital	\$44,028	\$ 18,123
Changes in components of working capital:		
Increase (decrease) in current assets:		
Cash and short-term investments	\$34,754	\$ 10,306
Accounts receivable	13,024	(1,225)
Installment contracts, commissions and notes receivable	1,680	1,342
Inventories	8,958	(8,171)
Prepaid expenses	(167)	378
	58,249	2,630
Increase (decrease) in current liabilities:		
Notes payable	3,666	(7,690)
Current maturities of long-term debt	169	2,164
Accounts payable and accrued liabilities	6,048	(7,674)
Income taxes payable	4,338	(2,293)
	14,221	(15,493)
Increase in working capital	\$44,028	\$ 18,123

See accompanying notes and schedule.

Notes to Consolidated Financial Statements

1. Summary of accounting policies

Principles of consolidation: The accompanying consolidated financial statements include the accounts of the Company and all of its wholly- and majority-owned subsidiaries. In January, 1976, Reserve purchased all of the outstanding stock of Basin Petroleum Corp. for a consideration of \$41,850,000, consisting of \$38,567,000 cash and 5-year warrants valued at \$3,283,000 to purchase 875,559 shares of Reserve's common stock at \$10.00 per share. The acquisition was accounted for using the purchase method. The total purchase price was allocated to the net tangible assets acquired based upon their estimated fair value.

Short-term investments: Certificates of deposit, bankers' acceptances, commercial paper and government obligations are carried at cost, which approximates market.

Inventories: Crude oil, refined products and sulfur inventories are carried principally at average cost, except for inventories of refined products and purchased domestic crude oil, which are recorded on the last-in, first-out method.

Carrying values are lower than market values; the current cost of inventories exceeds the last-in, first-out cost at December 31, 1977 and December 31, 1976 by \$5,399,000 and \$4,432,000, respectively. Materials and supplies are carried at or below average cost. Subdivided land is carried at cost, which is less than market. Property taxes and interest relating to subdivided land are expensed as incurred.

Properties: Expenditures for oil and gas exploration (including geological costs, delay drilling rentals and dry hole costs) in the United States, except the outer continental shelf (OCS), are expensed as incurred; costs of producing properties are capitalized. Costs of acquiring non-producing mineral rights are capitalized and charged to expense when surrendered. Depletion and depreciation of producing properties are computed on the unit-of-production method.

Exploration and development costs in Canada, other foreign areas and the OCS are capitalized under the full-cost method of accounting. Depletion and depreciation of Canadian properties are computed on the unit-of-production basis. Costs of other foreign and OCS properties are amortized over an estimated holding period until economic reserves are established, at which time the unit-of-production method will be utilized. At December 31, 1977 and 1976, total unamortized costs of Canadian properties amounted to \$52,951,000 and \$45,969,000 respectively, and unamortized costs of other foreign and OCS properties amounted to \$17,034,000 and \$11,377,000, respectively. See Note 11 for a discussion of the effects of newly adopted standards for

financial accounting and reporting by oil and gas producing companies.

Buildings and other equipment are depreciated under the straight-line and declining-balance methods at rates varying from 2½% to 33% per annum.

Maintenance and repairs are expensed as incurred; renewals and replacements which improve or extend the life of existing properties are capitalized and depreciated. Gain or loss is recognized upon sale or retirement of assets depreciated on the straight-line or declining balance method. For properties depreciated on the unit-of-production method, the cost of the asset sold or retired, less the amount realized, is charged to accumulated depreciation.

Income taxes: Deferred income taxes are provided for transactions which affect book and taxable income in different years. No provision is made for U.S. income taxes attributable to earnings of Canadian Reserve, as it is anticipated that accumulated earnings of \$22,978,000 at December 31, 1977 (\$17,693,000 at December 31, 1976) will be permanently invested in Canada.

In 1975, Reserve adopted the net change method of deferred tax accounting, as described in Statement of Financial Accounting Standards No. 9, with respect to timing differences relating to intangible drilling costs. Deferred income taxes have not been provided for such cumulative timing differences of approximately \$14,000,000 that arose prior to 1975. (See Note 11).

Investment tax credits of \$723,000 in 1977 (\$1,075,000 in 1976) have been accounted for under the flow-through method.

Employee benefit plans: The Company has a noncontributory pension plan, established in 1973, covering substantially all of its U.S. employees. At December 31, 1977, unfunded vested benefits were approximately \$526,000 (\$503,000 at December 31, 1976) and unfunded prior service costs were \$4,546,000 (\$2,647,000 at December 31, 1976). The increase in unfunded vested benefits and unfunded prior service costs is principally due to changes in certain actuarial assumptions in 1977. Pension expense was \$994,000 in 1977 and \$852,000 in 1976, including amortization of prior service costs over periods not exceeding forty years. The Company's policy is to fund not less than the pension costs accrued.

Reserve also has a thrift plan for the benefit of most U.S. employees. Generally, participants under the plan are permitted to contribute from 1% to 5% of regular base pay, and Reserve contributes an amount equal to the aggregate of employee contributions. Reserve may make additional contributions under the provisions of the plan,

but has never done so. Reserve's contributions of \$553,000 in 1977 and \$426,000 in 1976 were charged to operations.

An executive incentive bonus plan provides for annual awards to eligible executives of an amount not to exceed 3% of "adjusted consolidated net income of Reserve," as defined in the plan. Awards accrued in 1976 and made in 1977 totaled \$312,000. Awards of \$367,000, based on 1977 results, may be made in 1978 and have been accrued at December 31, 1977.

Under a similar employee incentive plan adopted by Canadian Reserve, awards of \$177,000 were accrued in 1977 for estimated 1978 payments. Awards of \$166,000 were accrued in 1976 and paid in 1977.

Per share data: Primary income per common share is based upon weighted average common shares outstanding and common stock equivalents for assumed exercise of stock options and warrants in each year where applicable, after provision for preferred dividend requirements. The number of shares used to compute primary income per share was 13,575,000 and 12,886,000 in 1977 and 1976, respectively.

Income per share assuming full dilution is based upon the weighted average number of common shares and common stock equivalents outstanding during each year and the assumed conversion of preferred shares into common shares. The number of shares used to compute income per share assuming full dilution was 13,913,000 and 13,363,000 in 1977 and 1976, respectively.

2. Installment contracts, commissions and notes receivable

These receivables total \$11,321,000 at December 31, 1977 (\$11,743,000 at December 31, 1976) after reduction for deferred profit on residential land sales contracts and commissions receivable of \$2,178,000 (\$2,608,000 at December 31, 1976). Annual maturities approximate \$4,018,000 in 1978 and decline to \$1,027,000 by 1982.

3. Inventories

Inventories used in the computation of cost of sales are as follows:

December 31 (In thousands)	1977	1976	1975	1974
Petroleum products and sulfur	\$21,748	\$12,791	\$23,262	\$6,137
Materials and supplies	4,401	4,435	2,482	1,554
Subdivided land, principally under development	2,074	2,039	1,692	1,619
	\$28,223	\$19,265	\$27,436	\$9,310

4. Financing arrangements

Long-term debt and other long-term payables at December 31, 1977 and 1976 consist of the following:

	1977	1976
	(In thousands)	
Notes payable to insurance companies at 10%, due \$6,000,000 annually from 1982 through 1991	\$60,000	\$60,000
Notes payable to banks, at not more than ½% above prime, due 1978 through 1985	21,000	23,000
Other (including obligations of subsidiaries of \$4,010,000 in 1977; \$5,230,000 in 1976)	9,553	10,751
	90,553	93,751
Less current maturities	5,330	5,161
	\$85,223	\$88,590

The loan agreement covering the notes payable to insurance companies requires, among other provisions, maintenance of a minimum level of working capital and imposes limitations and restrictions on borrowings, investments and dividends. Retained earnings of approximately \$15 million at December 31, 1977 (\$10 million at December 31, 1976) were not restricted as to payment of dividends under the terms of the agreement.

The prime rate applicable to the bank loans was 7¾% at December 31, 1977 (6¼% at December 31, 1976).

Compensating balances (all unrestricted as to withdrawal) required under all bank financing arrangements amounted to approximately \$7.6 million at December 31, 1977, including \$3.1 million related to unused lines of credit. Average balances required in 1977 were approximately \$7.9 million.

The aggregate amounts of minimum maturities of long-term debt are as follows: 1979 — \$3,537,000; 1980 — \$5,159,000; 1981 — \$2,865,000; 1982 — \$8,836,000; and thereafter \$64,826,000.

Under short-term bank financing arrangements, Reserve borrowed a maximum of \$20 million in 1977 (\$12.25 million in 1976) at prime (½% above prime in 1976). The average amount borrowed during 1977 was \$3.0 million (\$7.4 million in 1976) at an average interest rate (actual expense divided by average monthly short-term borrowings) of 8% in 1977 and 1976. At December 31, 1977, Reserve had bank credit commitments of \$57.5 million (\$53.9 million unused), \$10 million of which expires in 1978 and the balance being of indefinite term.

5. Shareholders' equity

At December 31, 1975, Reserve had four series of 5½% cumulative, convertible, voting (except Series C), preferred stock outstanding. During 1976, the Series A and Series B preferred stock issued were called for redemption and, as a result, 120,525 shares of such preferred stock were converted into 305,602 shares of common stock, 3,768 shares were redeemed for cash

and 2,435 treasury shares were cancelled. In 1976, 32,488 shares of Series D preferred stock were converted into 58,021 shares of common stock. In February, 1977, Reserve called the Series C and Series D issues for redemption at 103% and 104% of par value, respectively. As a result, 128,400 shares of such preferred stock were converted into 229,810 shares of common stock and 1,050 shares were redeemed for cash during 1977.

In November, 1977, Reserve's shareholders authorized 4 million shares of \$1 par value preferred stock and Reserve sold 2 million shares of cumulative convertible preferred stock at a price of \$25.00 per share. The preferred stock issued carries a dividend rate of \$1.75 per share, has a liquidation preference of \$25 per share, and is convertible into 1.46 shares of common stock. The preferred shares are redeemable at any time after January 1, 1978 at the option of the Company, initially at \$26.75 per share and at declining prices thereafter.

Warrants for the purchase of 875,559 common shares at \$10 per share, expiring in 1981, and warrants for the purchase of 10,720 common shares at \$11.25 per share, expiring in 1978, were issued in 1976 in connection with the purchase of Basin Petroleum Corp. Warrants exercised in 1977 and 1976 totaled 1,167 and 906, respectively.

At December 31, 1977, 4,497,866 shares of common stock were reserved as follows: 693,660 for exercise of outstanding stock options, 884,206 for outstanding warrants, and 2,920,000 for conversion of preferred stock. In December, 1977, the Company retired 4,767 shares of common stock held in treasury.

6. Income taxes

The components of income tax expense are as follows:

(In thousands)	1977	1976
Federal income tax		
Current	\$ 9,159	\$ 5,419
Deferred	(2,021)	825
State income tax		
Current	1,512	1,360
Foreign income tax		
Current	1,675	1,952
Deferred	2,043	1,521
	\$12,368	\$11,077

The principal components of deferred federal income tax expense are as follows:

(In thousands)	1977	1976
Net change in cumulative book/tax differences with respect to exploration costs	\$ 633	\$800
Earnings of Western European subsidiaries	(2,313)	(367)
Other	(341)	392
	\$(2,021)	\$825

Deferred foreign income tax relates principally to drilling and exploration costs and depreciation differences in Canada. Reserve's effective income tax rate in 1977 and 1976 is less than the statutory federal income tax rate of 48%, as a result of the items tabulated below:

	1977	1976
Income tax expense:		
Federal income tax	48.0%	48.0%
Investment tax credit	(2.4)	(4.1)
Lower effective tax rate on Canadian income	(3.2)	(4.8)
State income tax	2.6	2.7
Dividend exclusion on undistributed earnings of unconsolidated affiliates	(2.0)	(1.5)
Other	(2.1)	2.1
	40.9%	42.4%

7. Stock-option plans

Reserve has several stock-option plans for officers and key employees, approved by shareholders. Under these plans, options were granted in 1975 and prior years at the market price at the grant date, are exercisable one year after the grant date and expire five years after the grant date. At December 31, 1977, options for 85,060 shares (113,263 shares at December 31, 1976) were exercisable and, since December 31, 1975, no shares have been available for grant under these plans.

In October, 1976, the Board of Directors adopted, and in May, 1977 the shareholders approved, a non-qualified stock-option plan under which options for a maximum of 750,000 common shares may be granted to officers and key employees. Under the plan, certain optionees were granted (subject to final approval by the Compensation Committee of the Board of Directors at the date of exercise) appreciation rights payable in cash and/or stock to the extent that the market value of the common stock at the date of exercise exceeds the exercise price of the non-qualified stock option. Compensation expense is being accrued for appreciation rights granted. Options granted under this plan are at the market price at the grant date, are exercisable in segments over a period of years commencing no earlier than one year after the grant date and expire ten years after the grant date. During 1976, 306,000 shares (300,000 of which have appreciation rights) were granted at option prices ranging from \$14.94 to \$17.63 per share. During 1977, 310,100 shares were granted at option prices ranging from \$15.81 to \$18.94 per share and 7,500 shares (at \$18.94 per share) were cancelled. At December 31, 1977, 153,000 shares were exercisable and options for 141,400 shares (444,000 at December 31, 1976) were available for future grant under this plan.

Upon exercise of options, the excess of the proceeds over the par value of the shares issued is credited to

capital in excess of par value; no charges are made to income in connection with the exercise.

In addition to Reserve's stock-option plans described above, Canadian Reserve has a stock-option plan under which options are granted at 90% of market value at the grant date, become exercisable in annual 20%

increments beginning one year after the grant date and expire ten years after the grant date. At December 31, 1977, options for 134,200 shares (126,100 at December 31, 1976) were exercisable and 8,200 shares (61,200 at December 31, 1976) were available for granting of future options.

The following table sets forth additional information with respect to the Reserve and Canadian Reserve stock options:

Reserve					
	Number Of Shares	Option Price		Market Value	
		Per Share	Total	Per Share	Total
Options becoming exercisable:				At date exercisable	
1975	132,000	\$ 4.38- 8.75	\$ 694,751	\$ 4.88- 9.75	\$ 999,875
1976	95,000	6.13- 9.63	670,300	8.38-14.25	1,309,525
1977	153,000	14.94-17.63	2,293,875	13.38-14.25	2,049,000
Options exercised:				At date exercised	
1975	30,200	\$ 4.50- 8.29	\$ 189,010	\$ 7.50- 9.88	\$ 283,954
1976	182,561	4.38- 9.88	1,124,410	7.75-18.13	2,474,659
1977	26,203	4.50- 9.63	163,679	15.88-20.88	493,338
Options outstanding:		December 31, 1977		December 31, 1976	
Year	Option Price	Number of	Total	Number of	Total
Option Granted	Per Share	Shares	Option Price	Shares	Option Price
1971-1974	\$ 4.50- 7.50	42,200	\$ 225,013	62,859	\$ 347,471
1975	7.00- 9.63	37,860	265,020	45,404	321,240
1976	7.50-17.63	311,000	4,625,250	311,000	4,625,250
1977	15.81-18.94	302,600	5,685,466	—	—
		693,660	\$10,800,749	419,263	\$5,293,961

Option Shares			
Year	Granted	Cancelled	Expired
1976	311,000	4,037	—
1977	310,100	7,500	2,000

Canadian Reserve					
	Number Of Shares	Option Price		Market Value	
		Per Share	Total	Per Share	Total
Options becoming exercisable:				At date exercisable	
1975	29,700	\$ 3.20	\$95,040	\$2.12-2.75	\$ 75,425
1976	30,300	2.03-3.20	93,099	3.90-4.20	127,445
1977	14,700	2.03-3.42	45,185	5.75-6.87	100,232
Options exercised:				At date exercised	
1975	None	\$ —	\$ —	\$ —	\$ —
1976	5,400	2.03-3.20	16,227	3.95-4.60	21,755
1977	8,000	2.03-3.42	25,016	6.25-7.50	54,778
Options outstanding:		December 31, 1977		December 31, 1976	
Year	Option Price	Number of	Total	Number of	Total
Option Granted	Per Share	Shares	Option Price	Shares	Option Price
1971-1974	\$ 3.20	129,400	\$ 414,080	135,000	\$432,000
1975	2.03	12,700	25,781	16,500	33,495
1976	3.42	25,400	86,868	27,000	92,340
1977	4.36-6.30	106,000	570,540	—	—
		273,500	\$1,097,269	178,500	\$557,835

Option Shares			
Year	Granted	Cancelled	Expired
1976	27,000	12,600	—
1977	109,000	6,000	—

8. Contingencies

Reserve and its consolidated subsidiaries are involved in various lawsuits and disputes arising in the normal course of business. Based on presently available information, management believes that any liabilities which may result from legal proceedings will not have a material effect on Reserve's financial position.

The petroleum industry continues to be subject to regulation by the Department of Energy (DOE), which among other things imposes price restraints and subjects Reserve to the DOE's entitlement program. Although these regulations are complex and

continuously modified, Reserve's management believes that the Company has complied with the regulations and that in the event of a DOE review, no material adjustments to its consolidated financial statements would result.

At December 31, 1977, Reserve and its consolidated subsidiaries were contingently liable for approximately \$29 million: \$21 million in loan guarantees for Texoma Pipe Line Company (20% owned by Western Crude) and \$8 million in other loan guarantees and open letters of credit.

9. Quarterly information (unaudited)

The following table summarizes the results of the Company's operations by quarter in 1977 and 1976.

Quarter	Revenues		Income Before Income Taxes		Net Income		Net Income Per Common Share			
	1977	1976	1977	1976	1977	1976	Primary		Fully-diluted	
	(In thousands)		(In thousands)		(In thousands)		1977	1976	1977	1976
First	\$436,944	\$329,489	\$8,344	\$7,127	\$4,662	\$3,913	\$.34	\$.31	\$.34	\$.30
Second	457,386	360,175	7,850	6,602	4,369	3,604	.32	.27	.32	.27
Third	389,663	374,688	7,935	6,764	4,708	4,027	.35	.31	.35	.30
Fourth	377,382	409,644	6,118	5,648	4,140	3,520	.28	.26	.28	.26

10. Estimated replacement cost data (unaudited)

In compliance with rules of the Securities and Exchange Commission (SEC), Reserve has estimated certain replacement cost information with respect to inventories, properties, cost of sales and depreciation. However, replacement cost data for Reserve's substantial mineral resource assets are exempt from the SEC disclosure requirements. To illustrate the magnitude of this exemption, it is noted that mineral resource assets and other exempt properties at December 31, 1977 comprise 72% (70% at December 31, 1976) of the net historical cost of properties reported in Reserve's consolidated balance sheet. The principal activities for which replacement cost data are reported are, therefore, limited to petroleum drilling, refining, transportation and marketing; manufacturing; land development; and commercial and other miscellaneous activities.

The estimated replacement cost of the inventories and properties described above as of December 31, 1977 and 1976, together with estimates of depreciation, cost of sales and operating expenses determined on the basis of replacement cost for the year then ended is detailed in the table on the following page.

The replacement costs of petroleum product and sulfur inventories have been estimated using the first-in, first-out method. This method reasonably approximates replacement cost as a result of government price regulations and high turnover. Other inventories at replacement cost have been estimated using current published prices.

Replacement cost estimates for properties have generally been determined by applying to historical costs appropriate governmental and commercial indices, modified for known technological and environmental factors. Management disclaims responsibility for the accuracy of these indices. In specific instances, replacement cost has been determined based on appraisals or other information deemed most appropriate by the management of Reserve. The 1977 replacement cost estimates include data from cost studies developed in connection with the modernization and expansion program currently in progress at Reserve's oil refinery.

Replacement cost for cost of sales has been approximated by using the last-in, first-out method of costing inventories.

Accumulated depletion and depreciation and depletion and depreciation expense determined on a replacement cost basis were calculated using the straight-line method over the same economic lives used for financial accounting purposes. Average replacement cost of assets at the beginning and end of the year was used in the calculation of current replacement cost depreciation expense.

The replacement cost data reported in the accompanying table is not indicative of either the amounts for which the assets could be sold or of management's intentions with respect to the replacement of such assets, nor is it

necessarily representative of costs that may be incurred in a future period. Although substantial effort was expended to develop the required data, it necessarily reflects imprecision which results from extensive estimation and use of subjective judgment decisions. Such imprecision is explicitly recognized by the SEC.

In management's view, the limited replacement cost data reported herein, as required by the SEC, excludes such important factors as the effect of price level changes on

assets other than inventory and certain material assets as noted and the effect of statutory taxing and regulatory policies which have a substantial effect on Reserve's operations. Accordingly, because of these factors and other unresolved conceptual problems, the replacement cost data presented does not reflect all of the effects of inflation and other economic factors and the related income effect on Reserve's operations.

Replacement Cost Data	1977		1976	
	Historical Cost	Estimated Replacement Cost	Historical Cost	Estimated Replacement Cost
(In thousands)				
December 31:				
Inventories:				
Petroleum products and sulfur	\$ 21,748	\$ 27,044	\$ 12,791	\$ 16,506
Other	6,475	8,378	6,127(1)	7,699
	<u>\$ 28,223</u>	<u>\$ 35,422</u>	<u>\$ 18,918</u>	<u>\$ 24,205</u>
Properties, excluding those exempt from replacement cost data (principally mineral resource properties)	\$ 75,249	\$ 166,330	\$ 72,914	\$ 118,432
Accumulated depletion and depreciation thereon	22,939	90,231	22,470	49,840
Net properties for which replacement cost is provided	<u>52,310</u>	<u>\$ 76,099</u>	<u>50,444</u>	<u>\$ 68,592</u>
Mineral resource and other exempt properties, net of accumulated depletion and depreciation	132,887		115,061	
Amounts reported in accompanying consolidated financial statements	<u>\$ 185,197</u>		<u>\$ 165,505</u>	
Year ended December 31:				
Cost of sales and operating expenses	\$ 1,573,879	\$ 1,574,612	\$ 861,605(2)	\$ 861,882
Depreciation, depletion and abandonments for which replacement cost data are provided	\$ 5,099	\$ 7,382	\$ 4,303	\$ 5,739
Depletion, depreciation and abandonments related to mineral resource properties	13,922		15,003	
Amounts reported in accompanying consolidated financial statements	<u>\$ 19,021</u>		<u>\$ 19,306</u>	

(1) Amount excludes minor properties exempt under SEC rules in 1976 only.

(2) Amount excludes substantial cost of sales and operating expenses originating from operations outside of North America and the European Economic Community; such operations were exempt under SEC rules in 1976 only.

11. FAS No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies"

In December, 1977, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 19 (FAS No. 19) which adopts new accounting and reporting rules that will require oil and gas producers to account for certain exploration and development costs on a "successful-efforts" method rather than a "full-cost" method. Reserve presently uses successful-efforts accounting for U.S. operations, except on the outer continental shelf (OCS). Full-cost is used for OCS and foreign operations, including those in Canada. The provisions of FAS No. 19 will be effective for financial statements for fiscal years beginning after December 15, 1978. The Securities and Exchange Commission has announced that it will conduct further hearings before adopting any new oil and gas accounting and reporting rules.

FAS No. 19 prescribes specific techniques for computing

depletion by the unit-of-production method. Reserve has historically calculated unit-of-production depletion and depreciation using a composite rate for its major divisions. The new accounting standard prohibits this previously acceptable method and requires that depletion and depreciation be computed either on a property-by-property basis or on the basis of some reasonable aggregation of properties with a common geological structural feature or stratigraphic condition, such as a reservoir or field.

FAS No. 19 also supersedes FAS No. 9, "Accounting for Income Taxes — Oil and Gas Producing Companies." FAS No. 9 permitted (and Reserve adopted) the net change method of applying interperiod tax allocation procedures to intangible drilling and development costs and other costs which enter into the determination of taxable income and pretax accounting income in different periods. FAS No. 19 rescinds this accounting method.

Reserve's management estimates that upon restatement, as required by FAS No. 19, prior years' earnings (before extraordinary items) could be reduced by an average of approximately 15% per year and shareholders' equity at December 31, 1977 could be reduced by approximately 10%. The effect on earnings in 1977 is not expected to be significant. Management's estimates are based on preliminary studies completed to date and are subject to revision due to additional information obtained in compiling the necessary restatement data and

subsequent changes in interpreting the final provisions of the accounting standard.

The effects of FAS No. 19 on the covenants of the loan agreements entered into by the Company have not been fully assessed, but management believes that the Company's ability to comply with these covenants, including its ability to incur additional debt, make additional asset acquisitions, and declare dividends, has not been significantly altered.

Schedule of Information as to Segments of Business

(In thousands, except per cent data)	Oil and Gas Exploration and Production			Petroleum Trading and Transportation			Refining and Marketing		Other Operations		Adjustments and Eliminations		Consolidated	
Year ended December 31, 1977:														
Revenues	\$	40,017		\$1,283,172		\$305,674		\$32,512					\$1,661,375	
Intersegment sales		3,198		35,447		6,482		3,739				\$(48,866)		—
Total revenues	\$	43,215	2.6%	\$1,318,619	79.3%	\$312,156	18.8%	\$36,251	2.2%			\$(48,866) (2.9%)		\$1,661,375 100%
Operating profit	\$	11,226	26.1%	\$ 12,645	29.4%	\$ 15,897	36.9%	\$ 3,274	7.6%				\$	43,042 100%
Other expense:														
Interest expense														9,015
General corporate expense														2,971
Minority interest in subsidiaries' net income														809
Income before income taxes													\$	30,247
Depletion, depreciation and abandonments	\$	13,913	73.1%	\$ 2,516	13.2%	\$ 718	3.8%	\$ 1,874	9.9%				\$	19,021 100%
Capital expenditures	\$	27,738	66.2%	\$ 10,681	25.5%	\$ 239	.6%	\$ 3,238	7.7%				\$	41,896 100%
At December 31, 1977:														
Identifiable assets	\$	152,338	33.5%	\$ 154,152	33.8%	\$ 80,486	17.7%	\$29,293	6.4%				\$	416,269 91.4%
Corporate assets														39,158 8.6%
Total assets													\$	455,427 100%

Information about World-Wide Operations

(In thousands, except per cent data)	United States		Canada		Europe		Other Foreign		Adjustments and Eliminations		Consolidated	
Year ended December 31, 1977:												
Revenues	\$1,279,016		\$	20,028		\$361,864		\$	467			\$1,661,375
Sales between geographic areas						84,482				\$ (84,482)		—
Total revenues	\$1,279,016	77.0%	\$	20,028	1.2%	\$446,346	26.9%	\$	467	—%	\$ (84,482) (5.1%)	\$1,661,375 100%
Operating profit (loss)	\$	36,333 84.4%	\$	9,650 22.4%		\$ (2,200) (5.1%)		\$	(741) (1.7%)			\$ 43,042 100%
Other expense:												
Interest expense												9,015
General corporate expense												2,971
Minority interest in subsidiaries' net income												809
Income before income taxes												\$ 30,247
At December 31, 1977:												
Identifiable assets	\$	322,695 70.8%	\$	65,025 14.3%		\$ 22,217 4.9%		\$ 6,332 1.4%			\$ 416,269 91.4%	
Corporate assets												39,158 8.6%
Total assets												\$ 455,427 100%

See note on following page.

Note to schedule of information as to segments of business: Reserve Oil and Gas Company is engaged in three primary lines of business: oil and gas exploration and production; petroleum trading and transportation; and refining and marketing.

Total revenues by segment include both sales to unaffiliated customers, as reported in Reserve's consolidated statement of income, and intersegment sales which are recorded at prevailing market prices.

Operating profit consists of total revenues less cost of sales and operating expenses. Operating profit information for both the business segments and geographic areas excludes the following items: interest expense, general corporate expense, minority interest in subsidiaries' net income and income taxes.

Identifiable assets are those assets used in each segment of the Company's operations. Corporate assets consist principally of cash and short-term investments and commercial properties. Identifiable assets in Canada consist primarily of oil and gas properties. Western European assets are primarily receivables and inventories arising from the purchase, sale and transportation of crude oil and petroleum products.

Reserve's foreign operations in 1976 included revenues of \$560 million, operating profit of \$9.1 million, and identifiable assets of \$100 million.



Report of Certified Public Accountants

The Board of Directors and Shareholders
Reserve Oil and Gas Company

We have examined the accompanying consolidated balance sheets of Reserve Oil and Gas Company at December 31, 1977 and 1976, and the related consolidated statements of income, shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Reserve Oil and Gas Company at December 31, 1977 and 1976, and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

Denver, Colorado
February 22, 1978

Future capital investments required for adequate expansion of producing facilities and for development wells which will permit recovery of the Company's proved oil and gas reserves set forth on page 18 have been estimated to be \$12,300,000.

Some of the net proved crude oil and natural gas liquid reserves are located in fields where producing rates are restricted below productive capacity by prorationing. The income from these reserves, therefore, is being deferred over a longer period of time which directly affects the present worth of the future income.

Reserve owns interests in certain fields which, in its opinion, have potential crude oil reserves over and above the proved reserves stated in this Report and which may be recoverable in the future by water flood operations or other secondary or pressure maintenance operations. The ultimate primary recovery to Reserve's interests in these fields has been estimated to be 9.9 million barrels. If and when the water flood programs which have been planned or initiated prove successful, as indicated by engineering studies, it would not be unusual to recover additional crude oil reserves approaching 75 percent of the amount produced by primary methods.

Reserve's leases and other mineral interests in lands, and Canadian Reserve's oil and gas reservations, permits and leases contain terms which are customary in the two areas. Reserve believes that its other foreign concessions are in material respects similar to concessions held by other oil companies. It is recognized by the Company that operations outside of the United States involve economic and political risks materially greater than those encountered in domestic operations.

Reserve's and Canadian Reserve's production is sold, generally, at posted field prices, customarily to major companies. In 1977 the average price received for crude oil and natural gas liquids was \$8.50 per barrel (C \$9.31 per barrel for Canadian production), after production taxes and transportation charges. Gas is usually sold from the wellhead pursuant to long-term contracts. In 1977, the average price received for gas was \$1.15 per Mcf (C \$1.12 per Mcf), net after processing charges with respect to sour gas for Canadian gas. On December 31, 1977, the United States rate of exchange for the Canadian dollar was \$0.9137.

At December 31, 1977, Canadian Reserve had producing property development bank loans outstanding in the principal sum of C \$890,000 at 8¾ percent interest.

Mohawk Petroleum has for many years had various sources of crude oil for its refinery at Bakersfield, California. Company management believes that adequate crude oil supplies will continue to be available in 1978.

Western Crude Oil purchases crude oil from a number of sources, no one of which accounted for more than 12 percent of total purchases in 1977. Western Crude Oil has firm sources for some of its crude oil supplies and in the past has been able to offset loss of supplies, if incurred, with new sources. Company management believes that it can maintain or increase its level of crude oil supplies in 1978.

Most domestic purchases and sales of crude oil by Western Crude Oil are by agreements, generally subject to 30/90 days cancellation notice. No single customer accounted for more than 15 percent of such sales in 1977. Company management believes that the loss of any single customer would not have a materially adverse effect on Western Crude Oil.

The various segments of the Company's business are all subject to intense competition. As an independent oil and gas exploration and development company, Reserve faces direct competition from much larger, integrated and often strongly financed major oil companies, as well as from a great number of small and medium-sized independent companies. This competition exists in both domestic and foreign operations and in all phases of operations including lease and property acquisition, purchase and sale agreements, and marketing. Similar strong competition exists in the other segments of Reserve's business and in regard to patents, trademarks, licenses, leases, franchises and other business matters.

Reserve is subject to a great number of governmental regulations in all segments of its business, which affect production, pricing, transportation, exporting, refining and marketing. Among agencies that impose rules and requirements on the Company are the Department of Energy, with its many functions, and a great number of regional and local air and water control boards, land use commissions and similar agencies. Regulatory requirements are imposed by such laws as the Occupational Safety and Health Act and the Employee Retirement Income Security Act. It is not possible to predict how future operations and earnings may be affected by existing or new regulations or changes in regulations.



ITEM 4. Parents and Subsidiaries

To the right is a list of all principal companies in which Reserve or a subsidiary of Reserve had an ownership interest on December 31, 1977.

Inactive subsidiaries are omitted. All majority-owned subsidiaries are consolidated in the accompanying financial statements. The remaining named subsidiaries (less than majority owned) and all unnamed subsidiaries, when considered in the aggregate as a single subsidiary, would not be significant and, consequently, financial statements of such subsidiaries are omitted.

ITEM 5. Legal Proceedings

There are no material legal proceedings pending.

	Place of Incorporation	Percent of Ownership
RESERVE OIL AND GAS COMPANY ("Parent")	California	
Apple Valley Ranchos Water Co.	California	100
Canadian Reserve Oil and Gas Ltd.	Alberta	88.3
Blue Star Petroleum (Malta) Ltd.	Malta	90
Colombian Reserve Oil and Gas Company	California	100
Frontier Hotels, Inc.	California	100
Halbouty Alaska Oil Company	Delaware	80.1
Mohawk Petroleum Corporation, Inc.	California	100
Reserve Oil, Inc.	Delaware	100
Basin Petroleum Corporation (U.K.) Ltd.	Great Britain	100
Basin Petroleum North Sea Corp.	Oklahoma	100
Basin Petroleum Turkey Corp.	Oklahoma	100
Petroleum Computer Center, Inc.	Oklahoma	100
R.A.F. Corporation	Illinois	58.23
Trend Construction Corporation	Oklahoma	93.34
Process Packages, Inc.	Oklahoma	100
Reserve Synthetic Fuels, Inc.	Delaware	100
RVO Insurance, Ltd.	Bermuda	100
Western Crude Oil, Inc.	Delaware	100
Automatic Gas Distributors, Inc.	Colorado	100
Banner, Inc.	Oklahoma	100
Bay Transport Corporation	Michigan	100
Butte Pipe Line Company	Delaware	19
Canyon Pipe Line Corporation	Texas	10
Gibson Holdings, Ltd.	Alberta	12.8
Northern Tier Pipeline Company	Montana	12.3
Pontotoc Oil Company	Oklahoma	100
Spruce Oil Corporation	Colorado	100
Texoma Pipe Line Company	Delaware	20
Uinta Pipeline Corporation	Utah	100
Wascana Pipe Line, Inc.	Delaware	33.3
Wascana Pipe Line, Ltd.	Saskatchewan	33.3
Wesco Gas Services, Inc.	Colorado	100
Wesco International, Inc.	Delaware	100
Easco S.A.	Switzerland	100
Easco G.m.b.H.	Germany	100
Wesco G.m.b.H.	Germany	100
Easco B.V.	Netherlands	100
Easco International S.A.r.L.	Lebanon	100
Easco Marine Ltd.	Great Britain	100
Easco Petroleum Ltd.	Great Britain	100
Wesco Petroleum Ltd.	Great Britain	100
Easco S.p.A.	Italy	100
S.A. Sinar Petroleum Cy N.V.	Belgium	100
Wesco Pipe Line Company	Oklahoma	100
Plains Pipe Line Company	Wyoming	100
West Shore Corporation	Michigan	100
Western Crude Terminals, Inc.	Oklahoma	100
Western Gravities, Inc.	Colorado	100
Wyanot Pipe Line Company	Michigan	100

ITEM 6.**Increases and Decreases in Outstanding Securities and Indebtedness****(a) Equity Securities Outstanding — Capital Stock by Title of Class**

	Common Stock	Preferred Stock		
	\$1.00 Par Value	\$25.00 Par Value	\$1.75 Cumulative	Convertible
		Series C	Series D	
(Number of Shares)				
Outstanding 1-1-77	12,893,989 (1)	9,600	119,850	—
Increases, year 1977				
Stock Options Exercised	26,203	—	—	—
Warrants Exercised	1,167	—	—	—
Preferred Stock Conversions	229,810	—	—	—
Preferred Stock Issued	—	—	—	2,000,000
Decreases, year 1977				
Treasury Stock Retired	(4,767)	—	—	—
Preferred Stock Conversions	—	(9,600)	(118,800)	—
Preferred Stock Redemptions	—	—	(1,050)	—
Outstanding 12-31-77	13,146,402	—	—	2,000,000

(1) Includes 4,767 treasury shares and shares owned by subsidiaries.

	Class A	Class B
Warrants		
(Number of Shares)		
Outstanding 1-1-77	874,653	10,720
Warrants exercised, year 1977	(1,167)	—
Outstanding 12-31-77	873,486	10,720
Stock Options	Common Stock Options	
(Number of Shares)		
Outstanding 1-1-77		419,263
Options granted, year 1977		310,100
Options cancelled, year 1977		(7,500)
Options expired, year 1977		(2,000)
Options exercised, year 1977		(26,203)
Outstanding 12-31-77		693,660

Reference: Note 7 to Consolidated Financial Statements

(b) Changes in Outstanding Debt Securities and Indebtedness Previously Reported in Reports on SEC Form 10-Q in 1977: None

(c) Changes in Outstanding Debt Securities and Indebtedness in the Period October 1 — December 31, 1977: None Reportable.

ITEM 7.**Changes in Securities and Changes in Security for Registered Securities****(a) Modification of Constituent Instruments**

Pursuant to shareholder approval obtained at a special meeting held November 8, 1977, the Company's Articles of Incorporation were amended to provide for an increase in the authorized shares of preferred stock from 476,121 shares to 4,000,000 shares and for a change in the par value from \$25.00 per share, with

respect to the 476,121 shares, to \$1.00 for all of the 4,000,000 shares of authorized Preferred Stock. The par value change was in conformance with the California General Corporation Law, as revised effective January 1, 1977, which generally abolished the concept of "par value" for corporation law purposes but, for tax or other statutory purposes, deems authorized shares of a California corporation to have a par value of \$1.00. The amended Articles of Incorporation did not alter the amount or par value per share of the 30,000,000 previously authorized shares of \$1.00 par value Common Stock.

(b) Limitation or Qualification of Rights as to a Class of Securities by Issuance of Another Class of Securities

As a result of amending its Articles of Incorporation in November, 1977, the Company may at any time issue up to 4,000,000 shares of preferred stock (\$1.00 par value) in one or more series with the Board of Directors authorized to fix or alter the dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provision), the redemption price or prices, the liquidation preferences of any unissued series of preferred stock, the number of shares constituting any such series and the designation thereof. On November 14, 1977, the Executive Committee of the Company's Board of Directors adopted a resolution providing for the issuance of 2,000,000 shares of \$1.75 Cumulative Convertible Preferred Stock (\$1.00 par value) and on November 15, 1977, the Securities and Exchange Commission declared effective a Registration Statement filed on Form S-7 (File No. 2-60043) covering the sale of such shares.

Out of the assets of the Company legally available for payment of dividends, holders of the 2,000,000 shares (the "Preferred Stock") are entitled to receive cumulative cash dividends at the annual rate of \$1.75 per share. If in any dividend period or periods full dividends upon the Preferred Stock have not been paid, such deficiency must be paid or declared and set apart for payment before funds may be paid or set apart for the purchase or redemption of the Common Stock of the Company.

In the event of default in dividends on the Preferred Stock aggregating the equivalent of six quarterly dividend payments, the holders of Preferred Stock have the rights to elect two Directors of the Company in addition to the then current Directors.

In case of a reduction of capital of the Company resulting in a distribution of assets or of any voluntary liquidation, dissolution or winding up of the Company, the holders of Preferred Stock will be entitled to receive out of the assets of the Company available for distribution to stockholders a liquidation distribution in an amount per share equal to the then applicable optional redemption price, together with dividends accrued to the date of payment, before any distribution to holders of the Common Stock of the Company.

(c) Withdrawal or Substitutions of Assets Securing Any Class of Registered Securities: None.

ITEM 8.

Defaults Upon Senior Securities
None.

ITEM 9.

Approximate Number of Equity Security Holders

Title of Class	Number of Record Holders (December 31, 1977)
Common Stock (\$1.00 Par Value)	17,616
\$1.75 Cumulative Convertible Preferred Stock (\$1.00 Par Value)	1,890
Common Stock Purchase Warrants, Class A	778
Common Stock Purchase Warrants, Class B	1
Common Stock Options	69

ITEM 10.

Submission of Matters to a Vote of Security Holders

A Special Shareholders Meeting was held in Los Angeles on November 8, 1977 to vote on a proposal to increase the amount of authorized preferred stock to four million shares, and to designate \$1.00 as the par value of the preferred stock. The action, which required an amendment of the Articles of Incorporation, was approved and two million shares of preferred stock were subsequently sold in an underwritten public offering.

ITEM 11.

Executive Officers of the Registrant

Name	Age	Position	Period of Service at Such Position
John R. McMillan	68	Chairman of the Board	Since Jan. 1974
Paul D. Meadows	51	President and Chief Executive Officer	Since May 1977
Cortlandt S. Dietler	56	Senior Vice President and President, Western Crude Oil, Inc.	Since May 1977
Harold F. Green	62	Senior Vice President	Since Mar. 1975
Malcolm McDuffie	62	Senior Vice President and President, Mohawk Petroleum Corporation, Inc.	Since May 1977
J. Edouard Michaud	46	Vice President, Planning and Development	Since Oct. 1974
Walter E. Cramer, Jr.	61	Vice President	Since Apr. 1966
Robert E. Aberley	52	Vice President and Treasurer	Since Jan. 1974
Thomas L. Deen	54	Secretary	Since Mar. 1975

There is no family relationship between any of the executive officers. Each is appointed by the Board of Directors to serve at the pleasure of the Board and has the following business experience:

Mr. McMillan, Director, President and Chief Executive Officer of the Company from 1963 through 1973, became Chairman of the Board in 1974. Mr. Meadows, a Vice President of the Company before becoming President of Canadian Reserve Oil and Gas Ltd. in 1968, became a director in 1970. He was elected President and Chief Operating Officer in 1974 and Chief Executive Officer in 1977. Mr. Dietler was President of Western Crude Oil, Inc. upon its merger with Reserve in April, 1973 and was elected a Director in May, 1973. He was named

Senior Vice President in May, 1977. Mr. Green became Secretary in 1956, Vice President in 1962, a Director in 1973 and was appointed Senior Vice President in 1975. Mr. McDuffie was named President of Mohawk Petroleum upon its merger into Reserve in 1969. In February, 1973 he was elected a Director and was named Senior Vice President in May, 1977. Mr. Cramer has been Vice President and a Director since 1966 when the Apple Valley Building and Development Co., of which he was an officer, was acquired by Reserve. Prior to being appointed an officer of Reserve in 1974, Mr. Michaud had served as Vice President of Development and Production for Canadian Reserve since June, 1972. Mr. Aberley has been Treasurer since 1962 and was elected Vice President in 1974. Mr. Deen, Assistant Secretary since 1963, was named Secretary in 1975.



ITEM 12.
Indemnification of Directors and Officers

Section 317 of the California Corporations Code makes provision for the indemnification of officers and directors in terms sufficiently broad to include indemnification under certain circumstances for liabilities (including reimbursement for expenses incurred) arising under the Securities Act of 1933, as amended.

In addition, the officers and directors of Reserve and its subsidiaries are covered by an insurance policy which protects the executive against direct liability or loss for any error, misleading statement, act, omission, neglect, or breach of duty while acting in his individual or collective capacity. The policy also protects Reserve in its obligation, pursuant to by-laws, charter or otherwise, to indemnify its executives for their personal loss due to legal actions directed against them in their capacity as directors and officers.

ITEM 13.
Financial Statements, Exhibits Filed and Reports on Form 8-K

(a) 1. Financial Statements
The 1977 and 1976 consolidated financial statements together with the report thereon of Arthur Young & Company dated February 22, 1978, appear on pages 32 through 42.

The balance sheet of the Company (not consolidated) at December 31, 1977, the schedules of investments in and equity in earnings of affiliates and of consolidated properties and accumulated depletion and depreciation are to be filed separately under cover of SEC Form 8. All other schedules have been omitted since the required information is not present or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or the notes thereto. Copies of the Form 8 are available upon request from the Treasurer of the Company at 1776 Lincoln Street, Denver, Colorado 80203.

Financial statements of the Company (not consolidated) for the year ended December 31, 1977, other than the balance sheet, have been omitted since the Company is primarily a

holding company and has no significant operations of its own. Financial statements of the Company (not consolidated) for the year ended December 31, 1976 have been omitted since the Company was primarily an operating company, and all subsidiaries included in the consolidated financial statements being filed, in the aggregate, did not have minority equity interests and/or indebtedness to any person other than the registrant or its consolidated subsidiaries in amounts which together exceed 5 percent of the total assets at December 31, 1976.

2. Exhibits

(i) Computation of earnings per common share. (Unaudited)

(ii) Articles of Incorporation, as amended November 10, 1977. See the Company's Form 8-K Report for November, 1977.

(iii) Certificate of Designation and Determination of Preferences of the \$1.75 Cumulative Convertible Preferred Stock, as filed November 14, 1977. See Exhibit 2(a)2 to (iv) below.

(iv) Form S-7 Registration Statement, as filed November 15, 1977. See SEC Securities Act File No. 2-60043.

(b) The following items have been reported on Form 8-K during the three months ended December 31, 1977:

1. On December 8, 1977, Item 5 regarding "Other Materially Important Events" was filed reporting the special meeting of shareholders held November 8, 1977, which resulted in the approval of an amendment of the Company's Articles of Incorporation to provide for an increase in authorized capital stock to 4,000,000 shares of Preferred Stock (\$1.00 par value). Authorization for 30,000,000 shares of Common Stock was unaffected. Also reported was the adoption on November 14, 1977, of a resolution by the Executive Committee of the Board

of Directors providing for the issuance of 2,000,000 shares of \$1.75 Cumulative Convertible Preferred Stock, and the declaration by the Securities and Exchange Commission on November 15, 1977, of the effectiveness of a Registration Statement filed on Form S-7 (No. 2-60043) with respect to such Preferred Stock.

2. On December 8, 1977, Item 6 entitled "Financial Statements and Exhibits" incorporated by reference the Company's Amendment No. 1 to the Form S-7 Registration Statement (No. 2-60043) containing financial statements in connection with the issuance of 2,000,000 shares of \$1.75 Cumulative Convertible Preferred Stock.

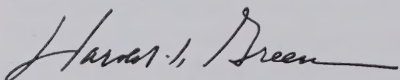
ITEMS 14 Through 18.

Registrant's Proxy Statement dated April 1, 1978, for the election of directors was filed with the Commission pursuant to Regulation 14A. Items 14 through 18, inclusive, are included in the Proxy Statement and, therefore, are omitted here.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RESERVE OIL AND GAS COMPANY
(Registrant)



By Harold F. Green
Senior Vice President

March 9, 1978

Corporate Offices

Executive Office:

1776 Lincoln Street
Denver, Colorado 80203

Paul D. Meadows, President and
Chief Executive Officer

Office of the Chairman:

550 South Flower Street
Los Angeles, California 90071

John R. McMillan, Chairman
of the Board

Transfer Agents/Registrars

Security Pacific National Bank

Corporate Trust Division
333 South Hope Street
Los Angeles, California 90071

The Chase Manhattan Bank, N.A.

One Chase Manhattan Plaza
New York, New York 10015

Shareholders and Employees

Shareholders	19,506
Employees	2,217

Communications

Reserve welcomes those who became shareholders since the last Annual Report. It is the Company's policy to keep shareholders fully informed of its activities. Copies of past Annual or Quarterly Reports, or other Company materials may be obtained by writing the Director, Corporate Communications.

This Report is the 20th consecutive annual report for which Louis Shawl of San Francisco has been graphic design consultant. Mr. Shawl's dedication to the interests of the Company over these years has been greatly appreciated.



